CLERK'S COPY

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 406

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THOMAS A. O'DONNELL

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 11, 1937

CERTIORARI GRANTED OCTOBER 25, 1937

No. 8186

United States

Circuit Court of Appeals

For the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

THOMAS A. O'DONNELL,
Respondent.

Transcript of the Record

Upon Petition to Review an Order of the United States Board of Tax Appeals.

Parker Printing Co., 545 Sansome Street, San Francisco 60—6-18-38

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 406

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THOMAS A. O'DONNELL

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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Docket No. 52987.

APPEARANCES:

For Petitioner:
THOMAS R. DEMPSEY, Esq.,
A. CALDER MACKAY, Esq.

For Respondent:
I. GRAFF, Esq.

THOMAS A. O'DONNELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES:

Transferred to Mr. Black 2/4/35.

1931

Feb. 19—Petition received and filed. Taxpayer notified. (Fee paid).

Feb. 19—Copy of petition served on General Counsel.

Apr. 17—Answer filed by General Counsel.

Apr. 24—Copy of answer served on taxpayer—Circuit Calendar.

1934

Mar. 30—Hearing set for week of June 4, 1934, Beverly Hills, California.

Apr. 24—Application for order to take depositions filed by taxpayer.

1931

May 1—Order to take depositions of T. A. O'Donnell and Mrs. T. A. O'Donnell entered.

June 5—Hearing had before Mr. Adams, Division 12, on merits. Depositions of Mr. and Mrs. T. A. O'Donnell admitted in evidence. Consolidated with 62979. Amended petition filed—copy served. Stipulation of facts filed. Petitioner's brief due Aug. 5, 1934—Commissioner's reply 8/21/34.

June 12—Transcript of hearing June 5, 1934 filed.

Aug. 4—Brief filed by taxpayer. 8/6/34 copy served.

Aug. 21—Motion for extension to Sept. 20, 1934 to file brief filed by General Counsel. 8/21/34 granted.

Sept. 20—Motion for extension to Oct. 20, 1934 to file brief filed by General Counsel. 9/20/34 granted to 10/20/34.

Oct. 20—Brief filed by General Counsel.

Oct. 20—Amended Answer to Amended Petition filed by General Counsel. 10/20/34 copy served.

Nov. 6—Motion for leave to file supplemental brief filed by General Counsel—supplemental brief lodged. 11/6/34 granted.

Dec. 18—Order that petitioner's reply brief be received and filed as of this date entered.

Dec. 18—Reply brief filed by taxpayer. 12/20/34 copy served.

1935

Aug. 29—Findings of fact and opinion rendered—Mr. Black, Division 15. Decision will be entered under Rule 50.

Oct. 11—Motion for order of redetermination under Rule 50 filed by General Counsel.

Oct. 14—Hearing set Nov. 6, 1935 on motion for settlement under Rule 50. [1*]

1935

Oct. 29—Consent to settlement filed by taxpayer.

Nov. 1—Decision entered—Mr. Black, Division 15.

Nov. 5—Order vacating decision, and decision entered—Mr. Black, Division 15.

1936

Jan. 22—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by General Counsel.

Feb. 5—Proof of service filed by General Counsel.

Mar. 20—Motion for enlargement of time for 60 days for preparation of evidence and transmission of record filed by General Counsel.

Mar. 20—Order enlarging time to 5/21/36 for preparation and delivery of record entered.

Apr. 11—Praecipe with proof of service thereon filed by General Counsel.

Apr. 11—Agreed statement of evidence lodged.

Apr. 14—Agreed statement of evidence approved and ordered filed. [2]

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*Page numbering appearing at the foot of page of original certified Transcript of Record.

Docket No. 62979.

APPEARANCES:

For Petitioner:
THOMAS R. DEMPSEY, Esq.,
A. CALDER MACKAY, Esq.

For Respondent:
I. GRAFF, Esq.

THOMAS A. O'DONNELL,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES:

Transferred to Mr. Black 2/4/35.

1932

Mar. 18—Petition received and filed. Taxpayer notified. (Fee paid).

Mar. 18—Copy of petition served on General Counsel.

Apr. 18—Answer filed by General Counsel.

Apr. 26—Answer served—Circuit Calendar.

1934

Mar. 30—Hearing set for week of June 4, 1934, Beverly Hills, California.

Apr. 24—Application for order to take depositions filed by taxpayer.

1932

May 1—Order to take depositions of Mr. and Mrs. T. A. O'Donnell entered.

June 5—Hearing had before Mr. Adams, Division 12, on merits. Depositions of Mr. and Mrs. T. A. O'Donnell admitted in evidence. Consolidated with 52987. Amended petition filed—copy served. Stipulation of facts filed. Petitioner's brief due 8/5/34—Commissioner's reply due 8/21/34.

June 12—Transcript of hearing June 5, 1934 filed.

Aug. 4—Brief filed by taxpayer. 8/6/34 copy served.

Aug. 21—Motion for extension to Sept. 20, 1934 to file brief filed by General Counsel. 8/21/34 granted.

Sept. 20—Motion for extension to Oct. 20, 1934 to file brief filed by General Counsel. 9/20/34 granted to 10/20/34.

Oct. 20—Brief filed by General Counsel.

Oct. 20—Amended answer to amended petition filed by General Counsel.

Nov. 6—Motion for leave to file supplemental brief filed by General Counsel—supplemental brief lodged. 11/6/34 granted.

Dec. 18—Order that petitioner's reply brief be received and filed this date entered.

Dec. 18—Reply brief filed by taxpayer. 12/20/34 copy served.

1935

Aug. 29—Findings of fact and opinion rendered—Mr. Black, Division 15. Decision will be entered under Rule 50.

Oct. 11—Motion for order of redetermination under Rule 50 filed by General Counsel.

Oct. 14—Hearing set Nov. 6, 1935 on motion for settlement under Rule 50.

Oct. 29—Consent to settlement filed by taxpayer. [3]

Nov. 1—Decision entered—Mr. Black, Division 15.

Nov. 5—Order vacating decision, and decision, entered—Mr. Black, Division 15.

1936

Jan. 22—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by General Counsel.

Feb. 5—Proof of service filed by General Counsel.

Mar. 20—Motion for enlargement of time for 60 days to prepare and transmit record filed by General Counsel.

Mar. 20—Order enlarging time to 5/21/36 to prepare and deliver record entered.

Apr. 11—Praecipe for record with proof of service thereon filed by General Counsel.

Apr. 11—Agreed statement of evidence lodged.

Apr. 14—Agreed statement of evidence approved and ordered filed. [4]

United States Board of Tax Appeals.

Docket No. 52987.

THOMAS A. O'DONNELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above named petitioner hereby appeals from the determination of the Respondent set forth in his deficiency letter dated December 22, 1930 (IT:E:Aj:COP-13531-60D) and as a basis of this proceeding alleges as follows:

I.

Petitioner is an individual residing at Los Angeles, California, with office address at 906 Security Building, Fifth and Spring Streets, Los Angeles, California.

II.

The deficiency letter, a copy of which is attached hereto, marked "Exhibit A", was mailed to petitioner on or about December 22, 1930.

III.

The taxes in controversy are income and profits taxes for the calendar years 1924, 1925, 1926 and 1927 in the sums of $335.57, $505.59, $3,966.54 and $7,003.28, respectively, aggregating $11,810.98.

IV.

The determination of the taxes set forth in said deficiency letter is based upon the following errors:

(a) Respondent erred in addition to petitioner's income for the calendar year 1924 in the sum of $250.00 alleged to represent a personal expense.

(b) Respondent erred in addition to petitioner's income for the calendar [5] years 1924 and 1925 the sums of $562.65 and $1,647.36, respectively, alleged to represent depletion sustained by the petitioner on a contract known as the "John H. Markham Contract".

(c) Respondent erred in adding to petitioner's taxable income for the calendar years 1926 and 1927 the sums of $15,700.85 and $27,069.99, respectively, alleged to represent income from San Gabriel Lease contract.

(d) Respondent erred in refusing and neglecting to reduce the petitioner's net taxable income by community earnings received during the calendar year 1927.

V.

The facts upon which petitioner relies as the basis of this proceeding are as follows:

(1) Petitioner is a citizen of the United States residing at Los Angeles, California and having his principal place of business at 906 Security Building, Los Angeles, California.

(2) Petitioner took as a deduction on his income tax return for the calendar year 1924 the sum of $250.00 as salary paid to one Emilo Mesonyi. The

service rendered to petitioner by this party was purely a business matter and the expenditure was an ordinary and necessary expense of doing business.

(3) Petitioner subsequent to March 1, 1913 acquired an interest in a lease contract known as the "John H. Markham Contract." At the time petitioner acquired this interest the land covered thereby was not in a proven area and petitioner's interest was not acquired as the result of purchase of a proven tract or lease; after the acquirement of this interest oil and gas was discovered on said premises and the fair market value of the property within thirty days after the discovery of oil and gas was materially disproportionate to the cost of the property to petitioner. Petitioner during the year 1924 [6] received the sum of $1,225.30 and during the year 1925 he received the sum of $3,295.72 as royalties under this lease. The respondent erroneously failed and neglected to allow any depletion on petitioner's interest and treated the foregoing sums as taxable income. Petitioner alleges that he is entitled to depletion based upon the fair market value of his interest within thirty days after the discovery of oil and gas on said property.

(4) Petitioner during the year 1926 transferred and conveyed to his wife, Mrs. Thomas A. O'Donnell all of his right, title and interest in and to that certain lease contract known as the "San Gabriel Lease Contract" and thereafter, during the years

1926 and 1927 Mrs. Thomas A. O'Donnell received the sums of $15,535.85 and $27,069.99, respectively. Petitioner is informed and believes and therefore alleges that Mrs. Thomas A. O'Donnell reported these sums in her income tax returns for the respective years 1926 and 1927 and paid taxes thereon. Petitioner did not receive the foregoing sums or any part thereof and consequently the action of the respondent in charging petitioner with these amounts is erroneous and illegal.

(5) Petitioner during the calendar year 1927 received salaries in the total amount of $62,500.00 which, under the laws of the State of California, constitutes community income, one-half of which is taxable to petitioner and one-half to his wife, Mrs. Thomas A. O'Donnell.

WHEREFORE, petitioner prays that the Board hear and determine this appeal and render judgment in accordance with the foregoing and allow such overassessments as may result therefrom.

THOMAS R. DEMPSEY
A. CALDER MACKAY
Attorneys for Petitioner
508 Security Building
Los Angeles, California. [7]

State of California
County of Riverside—ss.

Thomas A. O'Donnell, being first duly sworn, deposes and says: That he is the petitioner above named; that he has read the foregoing petition and

knows the contents thereof and that the same is true of his own knowledge except as to the matters which are therein stated upon his information and belief and that as to those matters he believes it to be true.

THOMAS A. O'DONNELL

Subscribed and sworn to before me this 14th day of February, 1931.

[Seal] ROBERT L. EDWARDS

Notary Public in and for said County and State.

[8]

EXHIBIT "A"

TREASURY DEPARTMENT
WASHINGTON

Office of
Commissioner of Internal Revenue

NP-2-26
Dec 22 1930

IT:E:Aj
COP-13531-60D

Mr. Thomas A. O'Donnell,
906 Security Bank Building,
Fifth and Spring Streets,
Los Angeles, California.

Sir:

You are advised that the determination of your tax liability for the years 1924, 1925, 1926 and 1927 discloses a deficiency of $11,810.98, as shown in the statement attached.

In accordance with section 274 of the Revenue Act of 1926, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your returns by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,
DAVID BURNET,
Commissioner.

By (Signed) J. C. WILMER
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870
RA-1. [9]

STATEMENT.

IT:E:Aj
COP-13531-60D

In re: Mr. Thomas A. O'Donnell
906 Security Bank Building,
Fifth and Spring Streets,
Los Angeles, California.

Years	Deficiency
1924 (Consent)	$ 335.57
1925 (Consent)	505.59
1926 (Consent)	3,966.54
1927	7,003.28
Totals	$11,810.98

A review of the report submitted by the internal revenue agent in charge, Los Angeles, California, covering your tax liability for the years 1924, 1925, 1926 and 1927, discloses a deficiency of $11,810.98.

1924

Net income reported	$317,035.78
Add:	
1. Salaries	250.00
2. Royalties	562.65
Total	$317,848.43
Less:	
3. Other income	66.93
Net income adjusted	$317,781.50

EXPLANATION OF ADJUSTMENTS.

1. Represents personal expenses deducted on the return from the salary received. Not an allowable deduction.

2. Represents additional income from royalties on the John H. Markham contract. No depletion is allowable.

3. Represents refund from the American Petroleum Institute for expenditures made in its behalf which should not have been included in taxable income. [10]

COMPUTATION OF TAX.

Net income		$317,781.50
Less:		
Dividends	$252,229.20	
Exemption	1,000.00	253,229.20
Balance subject to normal tax		$ 64,552.30
Normal tax at 2% on $4,000.00		$ 80.00
Normal tax at 4% on $4,000.00		160.00
Normal tax at 6% on $56,552.30		3,393.14
Surtax on $317,781.50		98,954.78
Total tax		$102,587.92
Less:		
Credit for earned income		75.00
Total tax assessable		$102,512.92
Tax previously assessed		102,177.35
Deficiency in tax		$ 335.57

1925

Net income reported	$397,945.53
Add:	
1. Royalties	1,647.36
2. Other deductions	375.
Adjudged net income	$399,967.89

EXPLANATION OF ADJUSTMENTS.

1. Depletion disallowed. See number 2 under 1924.

2. Represents attorney fees in personal affairs and, therefore, not deductible from income.

COMPUTATION OF TAX.

Net income		$399,967.89
		[11]
Brought forward		$399,967.89
Less:		
Dividends	$263,573.56	
Exemption	2,066.66	265,640.22
Balance subject to normal tax		$134,327.67
Normal tax at 1½% on $4,000.00		$ 60.00
Normal tax at 3% on $4,000.00		120.00
Normal tax at 5% on $126,327.67		6,316.38
Surtax on $399,967.89		71,653.58
Total tax		$ 78,149.96
Less:		
Credit of 25% for earned income		224.17
Total tax assessable		$ 77,925.79
Tax previously assessed		77,420.20
Deficiency in tax		$ 505.59

1926

Net income reported	$246,512.64
Add:	
1. Royalties	586.71
2. Other income	15,700.85
3. Contributions	25.00
Total	$262,825.00
Less:	
4. Interest	465.00
Net income adjusted	$262,360.20

EXPLANATION OF ADJUSTMENTS.

1. Royalties received increased on account of disallowance of depletion as follows: [12]

Depletion claimed	$1,303.80	
Depletion allowed based on 27½% of amount received	717.09	
Additional income		$ 586.71

2. Other income as follows:

Income from Building and Loan certificates	$ 165.00	
Income from San Gabriel lease contract held to represent taxable income to you instead of your wife	15,535.85	
Addition to income		$15,700.85

3. Contribution to W. C. T. U. not a deductible item.

COMPUTATION OF TAX.

Net income		$262,360.20
Less:		
Dividends	$170,611.50	
Exemption	3,900.00	174,511.50
Balance subject to normal tax		$ 87,848.70
Normal tax at 1½% on $4,000.00		$ 60.00
Normal tax at 3% on $4,000.00		120.00
Normal tax at 5% on $79,848.70		3,992.44
Surtax on $262,360.20		44,132.04
Total tax		$ 48,304.48
Less:		
Credit of 25% for earned income		201.25
Total tax assessable		$ 48,103.23
Tax previously assessed		44,136.69
Deficiency in tax		$ 3,966.54

[13]

1927

Net income reported	$272,883.21
Add:	
1. Salaries	2,519.81
2. Other income	27,069.99
3. Contributions	510.00
Total	$302,983.01
Less:	
4. Other income—Davis and Haines	2.283.36
Adjusted net income	$300,699.65

EXPLANATION OF ADJUSTMENTS.

1. Represents traveling expenses incurred by you on a trip to Europe under the auspices of the United States Chamber of Commerce. Not deductible from salaries received.

2. Represents income from the San Gabriel lease agreement reported by your wife but held to be properly taxable to you. See number 2 under the year 1926.

3. Represents the following:

Gift to Desert School District claimed and allowed in 1926	$500.00
Contribution to W. C. T. U.	10.00
Total	$510.00

4. Represents amount reported as income from Davis and Haines on final liquidation which belonged to the O'Donnell Oil and Securities Company.

COMPUTATION OF TAX.

Net income		$300,699.65
Less:		
Dividends	$241,378.72	
Exemption	3,900.00	245,278.72
Balance subject to normal tax		$ 55,420.93

[14]

Normal tax at 1½% on $4,000.00	$ 60.00
Normal tax at 3% on $4,000.00	120.00
Normal tax at 5% on 57,420.93	2,371.05
Surtax on $300,699.65	51,799.93
Total tax	$54,350.98
Less:	
Credit of 25% for earned income	201.25
Deficiency in tax	$ 54,149.73
Tax previously assessed	47,146.45
Deficiency in tax	$ 7,003.28

Payment should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

RA-1.

[Endorsed]: U. S. B. T. A. Filed Feb. 19, 1931.

[15]

[Title of Court and Cause.]

ANSWER.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits the allegations contained in paragraph II of the petition.

III. Admits that the taxes in controversy are Federal income taxes for the calendar years 1924, 1925, 1926 and 1927, but denies that the amounts in controversy are correctly stated in paragraph III of the petition.

IV. Denies that the respondent erred in the manner alleged in paragraph IV of the petition, subparagraphs (a), (b), (c) and (d).

V-(1). Admits the allegations of fact contained in subparagraph (1) of paragraph V of the petition.

V-(2),(3),(4) and (5). Denies the allegations of fact contained in subparagraphs (2), (3), (4) and (5) of paragraph V of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied. [16]

WHEREFORE, it is prayed that petitioner's appeal be denied.

(Signed) C. M. CHAREST
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
O. J. TALL,
Special Attorney,
Bureau of Internal Revenue.

amm
4-17-31

[Endorsed]: U. S. B. T. A. Filed Apr. 17, 1931.
[17]

United States Board of Tax Appeals.

Docket #52987.

THOMAS A. O'DONNELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

AMENDED PETITION.

Comes now the Petitioner and having first obtained leave of the Board files this, its amended petition, appealing from the determination of the Respondent set forth in his deficiency letter dated December 22, 1930, symbols IT:E:Aj:COP-13531-60D, and as a basis for this proceeding alleges as follows:

I.

Petitioner is an individual residing at Los Angeles, California, with office address at 906 Security Building, Fifth and Spring Streets, Los Angeles, California.

II.

The deficiency letter, (a copy of which was attached to the original petition and marked "Exhibit A"), was mailed to Petitioner on or about December 22, 1930.

III.

The taxes in controversy are income and profits taxes for the calendar years 1925, 1926 and 1927 in

the sums of $505.59, $3,966.54 and $7,003.28 respectively, aggregating $11,475.41.

IV.

The determination of the taxes set forth in said deficiency letter is based upon the following errors: [18]

(a) Respondent erred in failing to allow as a deduction from Petitioner's income for the calendar years 1925, 1926 and 1927 the respective sums of $13,824.26, $3,432.68 and $3,531.68, representing depletion sustained by the Petitioner on what is commonly known as the San Gabriel oil properties.

(b) Respondent erred in adding to Petitioner's taxable income for the calendar years 1926 and 1927 the sums of $15,700.85 and $27,069.99, respectively, alleged to represent income from San Gabriel Lease contract.

(c) If the Respondent did not err as alleged in paragraph (b) above then he erred in his failure to allow deductions for depletion equal to 27½% of the said amounts stated in said paragraph (b).

(d) Respondent erred in not reducing Petitioner's net taxable income for the year 1927 by the amount of community earnings which became vested in Petitioner's wife concurrently with their receipt.

V.

The facts upon which Petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner is a citizen of the United States residing at Los Angeles, California, and having his principal place of business at 906 Security Building, Los Angeles, California.

(b) Under date of January 9, 1918 the Petitioner, as first party, entered into an agreement with Petroleum Midway Company, Ltd., a corporation, as second party, under the terms of which Petitioner sold, assigned and transferred one-third of the entire outstanding capital stock of San Gabriel Petroleum Company then owned by him for and in consideration of the agreement to pay second party's one-third of the net profits to be thereafter received by second party from the development and operation of the properties then owned by San Gabriel Petroleum Company. The agreement further provided that the [19] second party would acquire all of the assets, rights and properties of the San Gabriel Petroleum Company and would cause the said Petroleum Company to disincorporate and dissolve.

(c) The Petroleum Midway Company, Ltd. caused the said San Gabriel Petroleum Company to dissolve and distribute all of its assets to it after which time and during the years here involved, the Petroleum Midway Company, Ltd., operated the said properties.

(d) During the years 1925 and 1926 the Petroleum Midway Company, Ltd. paid the Petitioner the respective sums of $50,270.02 and $12,482.48 as

his share of the profits due him under the said agreement which amount the Petitioner included as income in his income tax returns for the respective years of receipt and which amounts are included in the net income for the years 1925 and 1926 shown in the aforesaid deficiency letter.

(e) Notwithstanding the fact that the aforesaid payments received by the Petitioner under and in pursuance of the said agreement constituted income from the development and operation of oil properties and notwithstanding that Petitioner had an economic and depletable interest in the said properties the Respondent failed and refused to allow Petitioner any deductions for depletion sustained on said interest.

(f) On or about March 31, 1926 the Petitioner assigned, transferred and delivered all of his right, title and interest in and to the said agreement to his wife, who has ever since received the full benefits thereof. Notwithstanding this, the Respondent included in Petitioner's income for the year 1926 the sum of $15,535.85 and for the year 1927 the sum of $27,069.99, all of which was received by and belonged to Petitioner's wife.

(g) Petitioner was married during the entire year 1927 and during said year received salaries as compensation for personal services [20] rendered in the sum of $62,500.00, which under the laws of the State of California constituted community income. Notwithstanding this and the fact that Petitioner's wife filed a separate income tax return for

the said year, the Respondent in determining the deficiency for the year 1927 included the full amount of said salaries in Petitioner's income.

WHEREFORE, Petitioner prays that the Board hear and determine this appeal and render judgment in accordance with the foregoing and allow such overassessments as may result therefrom.

THOMAS R. DEMPSEY
A. CALDER MACKAY
Attorneys for Petitioner
1104 Pacific Mutual Bldg.,
Los Angeles, California. [21]

State of California
County of Los Angeles—ss.

Thomas A. O'Donnell, being first duly sworn, deposes and says: That he is the Petitioner above named; that he has read the foregoing amended petition and knows the contents thereof and that the same is true of his own knowledge except as to the matters which are therein stated upon his information and belief and as to those matters he believes it to be true.

THOMAS A. O'DONNELL

Subscribed and sworn to before me this 16th day of May, 1934.

[Seal] ADA E. STOMBS
Notary Public

Respondent entered a general denial to the amended petition at the hearing on June 5, 1934.

[Endorsed]: U. S. B. T. A. Filed at hearing June 5, 1934. [22]

[Title of Court and Cause.]

AMENDED ANSWER TO AMENDED PETITION.

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, for amended answer to the amended petition filed in the above-entitled appeal, admits and denies as follows:

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the amended petition.

4. Denies that the Commissioner erred as alleged in subparagraphs (a) to (d), inclusive, of paragraph 4 of the amended petition.

5(a) to (d), inclusive. Admits the allegations of fact contained in subparagraphs (a) to (d), inclusive, of paragraph 5 of amended petition.

5 (e) to (g), inclusive. Denies the allegations of fact contained in subparagraphs (e) to (g), inclusive, of paragraph 5 of amended petition.

Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that petitioner's appeal be denied.

(Signed) ROBERT H. JACKSON
Assistant General Counsel
for the
Bureau of Internal Revenue.

Of Counsel:
I. GRAFF,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed Oct. 20, 1934.

United States Board of Tax Appeals.

Docket No. 62979.

THOMAS A. O'DONNELL,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above named petitioner hereby appeals from the determination of the respondent set forth in his deficiency letter dated January 21, 1932 (IT:AR:E-2:IJ-60D) and as a basis of this proceeding alleges as follows:

I.

Petitioner is a citizen of the United States of America and resides at Los Angeles, California.

II.

Deficiency letter, a copy of which is attached hereto and marked Exhibit A, was mailed to the petitioner on or about January 21, 1932.

III.

The taxes in controversy are income taxes for the calendar years 1928 and 1929 in the sum of $5,392.81 and $979.41, respectively, aggregating $6,372.22.

IV.

The determination of the taxes set forth in the deficiency letter is based upon the following errors:

(1) Respondent erroneously added to petitioner's taxable income for the year 1928 the sum of $21,451.24 and for the year 1929 the sum of $4,080.95, no part of which was received by the petitioner.

(2) Respondent erroneously increased petitioner's taxable [24] income by the sum of $100.00 representing contributions.

V.

The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) Petitioner is now and during the years herein involved was a resident of the City of Los Angeles, State of California, and as such resident filed his income tax returns with the United States Collector of Internal Revenue for the Sixth District of California.

(b) Respondent erroneously and illegally added to petitioner's taxable income as disclosed by his returns for the years 1928 and 1929 the sums of $21,451.24 and $4,080.95, respectively, alleged to represent income from San Gabriel oil lease. No part of these sums was received by the petitioner during the years here involved and no part constitutes income subject to tax to this petitioner.

(c) During the year 1928 petitioner contributed $100.00 to the Southern California Olympic Games, an organization to promote the Olympic Games at Los Angeles, California. Respondent has erroneously

and illegally disallowed this as a deduction from taxable income.

WHEREFORE, it is prayed that the Board hear and determine this appeal and render judgment in accordance with the foregoing.

(Sgd) THOMAS R. DEMPSEY
(Sgd) A. CALDER MACKAY
(Sgd) ARTHUR McGREGOR [25]

State of California
County of Los Angeles—ss.

Thomas A. O'Donnell, being first duly sworn, deposes and says: That he is the petitioner above named; that he has read the foregoing petition and knows the contents thereof and that the same is true of his own knowledge except the matters which are therein stated to be upon information and belief and that as to those matters he believes it to be true.

(Sgd) THOMAS A. O'DONNELL

Subscribed and sworn to before me this 14th day of March, 1932.

[Seal] ADA E. STOMBS
Notary Public in and for said County and State.

[26]

EXHIBIT "A".

TREASURY DEPARTMENT
WASHINGTON

Office of
Commissioner of Internal Revenue

January 21, 1932

IT:AR:E-2
IJ-60D
Mr. Thomas A. O'Donnell,
906 Security Building,
Los Angeles, California.

Sir:

You are advised that the determination of your tax liability for the years 1928 and 1929 discloses a deficiency of $6,372.22, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your returns by permitting an early assessment of any deficiency and preventing the accumulation of interest charges,

since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,
DAVID BURNET,
Commissioner.
By (Sgd) J. C. WILMER
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870 [27]

STATEMENT.

IT:AR:E-2
IJ-60D

In re: Mr. Thomas A. O'Donnell
906 Security Building
Los Angeles, California.

TAX LIABILITY.

Years	Tax Liability	Tax Assessed	Deficiency
1928	$32,493.35	$27,100.54	$5,392.81
1929	24,132.71	23,153.30	979.41
	$56,626.06	$50,253.84	$6,372.22

The report of the internal revenue agent in charge at Los Angeles, California, has been reviewed and approved by this office as submitted.

1928

Net income reported on return		$170,731.92
Add:		
1. Income from oil lease	$21,451.24	
2. Contributions disallowed	120.00	21,571.24
Adjusted net income		$192,303.16
Less:		
Capital net gain		100.00
Income subject to surtax		$192,203.16
Less:		
Dividends	$131,205.50	
Personal exemption	3,500.00	132,705.50
Balance subject to normal tax		$ 57,497.66
Normal tax at 1½% on $4,000.00		$ 60.00
Normal tax on 3% on $4,000.00		120.00
Normal tax at 5% on $49,497.66		2,474.88
Surtax on $192,203.16		30,100.63
Tax at 12½% on capital net gain of $100.00		12.50
Total tax		$ 32,768.01
		[28]
Brought forward		$ 32,768.01
Less:		
Earned income credit	$174.66	
Tax paid at source	100.00	274.66
Total tax assessable		$ 32,493.35
Tax previously assessed		27,100.54
Deficiency in tax		$ 5,392.81

EXPLANATION OF CHANGES.

1. Income from San Gabriel Oil Lease profits is considered your separate income since property was not assigned to your wife until March 11, 1929.

2. Contributions to W. C. T. U. of $20.00 and $100.00 to Southern California Olympic Games were disallowed.

	1929	
Net income reported on return		$152,208.15
Add:		
1. Royalty on San Gabriel Lease		4,080.95
Adjusted net income		$156,289.10
Less:		
Capital net loss		2,066.22
Income subject to surtax		$158,355.32
Less:		
Dividends	$120,982.00	
Personal exemption	3,500.00	124,482.00
Balance subject to normal tax		$ 33,873.32
Normal tax at ½% on $4,000.00		20.00
Normal tax at 2% on 4,000.00		80.00
Normal tax at 4% on 25,331.06		1,034.93
Surtax on $158,355.32		23,331.06
		$ 24,465.99
Tax at 12½% on capital net loss		258.28
Total tax		$ 24,207.71

Brought forward	$ 24,207.71
Less:	
Earned income credit	75.00
Total tax assessable	$ 24,132.71
Tax previously assessed	23,153.30
	$ 979.41

EXPLANATION OF CHANGE.

1. Item of $4,080.95 represents profit from San Gabriel Oil Lease.

You are advised that the statutory period of limitations provided by sections 275 and 322 of the Revenue Act of 1928 was extended for one year by Joint Resolution of Congress (H. J. Res. 340) approved by the President June 16, 1930.

[Endorsed]: U. S. B. T. A. Filed Mar. 18, 1932. [30]

[Title of Court and Cause.]

ANSWER.

Comes now the Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits and denies as follows:

I. Admits the allegations of paragraph I of the petition.

II. Admits that the notice of deficiency was mailed to the petitioner on or about January 21,

1932, and denies the remainder of paragraph II of the petition.

III. Admits the allegations of paragraph III of the petition.

IV-(1) and (2). Denies that the respondent erred as alleged in subparagraphs (1) and (2) of paragraph IV of the petition.

V-(a) to (c) inclusive. Denies the allegations set forth in subparagraphs (a) to (c) inclusive, of paragraph V of the petition.

Denies generally and specifically each and every material allegation contained in the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the Board redetermine the amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, plus any additional amount which may arise from the correction of any error or errors that may have been committed by the Commissioner. Claim is hereby asserted for the increased deficiency, if any, resulting from such redetermination.

(Signed) C. M. CHAREST
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

A. H. FAST,
F. L. VAN HAAFTEN,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed Apr. 18, 1932

United States Board of Tax Appeals.

Docket No. 62979.

THOMAS A. O'DONNELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

AMENDED PETITION.

Comes now the Petitioner and having first obtained leave of the Board files this, its amended petition, appealing from the determination of the Respondent set forth in his deficiency letter dated January 21, 1932, symbols IT:AR:-E-2; IJ-60D, and as a basis for this proceeding alleges as follows:

I.

Petitioner is a citizen of the United States of America and resides at Los Angeles, California.

II.

The deficiency letter, (copy of which was attached to the original petition and marked "Exhibit A"), was mailed to the Petitioner on or about January 21, 1932.

III.

The taxes in controversy are income taxes for the calendar years 1928 and 1929 in the sum of $5,392.81 and $979.41, respectively aggregating $6,372.22.

IV.

The determination of the taxes set forth in the deficiency letter is based upon the following errors:

(1) Respondent erroneously added to Petitioner's taxable income [32] for the year 1928 the sum of $21,451.24 and for the year 1929 the sum of $4,080.95, no part of which was received by the Petitioner.

(2) If the respondent did not err as aforesaid, then he erred in failing and refusing to allow Petitioner deductions for depletion for the years 1928 and 1929 in the respective amounts of $5,899.09 and $1,222.26.

V.

The facts upon which the Petitioner relies as a basis of this proceeding are as follows:

(a) Petitioner is now and during the years herein involved was a resident of the City of Los Angeles, State of California, and as such resident filed his income tax returns with the United States Collector of Internal Revenue for the Sixth District of California.

(b) Under date of January 9, 1918 the Petitioner, as first party, entered into an agreement with Petroleum Midway Company, Ltd., a corporation, as second party, under the terms of which Petitioner sold, assigned and transferred one-third of the entire outstanding capital stock of San Gabriel Petroleum Company then owned by him for and in consideration of the agreement to pay second party's one-third of the net profits to be thereafter

received by second party from the development and operation of the properties then owned by San Gabriel Petroleum Company. The agreement further provided that the second party would acquire all of the assets, rights and properties of the San Gabriel Petroleum Company and would cause the said Petroleum Company to disincorporate and dissolve.

(c) The Petroleum Midway Company, Ltd. caused the said San Gabriel Petroleum Company to dissolve and distribute all of its assets to it after which time and during the years here involved, the Petroleum Midway Company, Ltd. operated the said properties. [33]

(d) On or about March 31, 1926 the Petitioner assigned, transferred and delivered all of his right, title and interest in and to the said agreement described in paragraph (b) above to his wife, who has ever since received the full benefits thereof. Notwithstanding this the Respondent has included in Petitioner's income for the years 1928 and 1929 the respective sums of $21,051.24 and $4,080.95, all of which was received by and belonged to Petitioner's wife.

WHEREFORE, it is prayed that the Board hear and determine this appeal and render judgment in accordance with the foregoing.

THOMAS R. DEMPSEY
A. CALDER MACKAY
Attorneys for Petitioner,
1104 Pacific Mutual Bldg.,
Los Angeles, California. [34]

State of California
County of Los Angeles—ss.

Thomas A. O'Donnell, being first duly sworn, deposes and says: That he is the Petitioner above named; that he has read the foregoing amended petition and knows the contents thereof and that the same is true of his own knowledge except as to the matters which are therein stated upon his information and belief and as to those matters he believes it to be true.

THOMAS A. O'DONNELL

Subscribed and sworn to before me this 16th day of May, 1934.

[Seal] ADA E. STOMBS,
Notary Public

Respondent entered a general denial to the amended petition at the hearing on June 5, 1934.

[Endorsed]: U. S. B. T. A. Filed at hearing, June 5, 1934. [35]

[Title of Court and Cause.]

AMENDED ANSWER TO AMENDED PETITION.

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, for amended answer to the amended petition filed in the above-entitled appeal, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of amended petition.

2. Admits the allegations contained in paragraph 2 of the amended petition.

3. Admits the allegations contained in paragraph 3 of the amended petition.

4. Denies the Commissioner erred as alleged in subparagraphs 1 and 2 of pagaraph 4 of amended petition.

5 (a) to (c), inclusive. Admits the allegations of fact contained in subparagraphs (a) to (c), inclusive, of paragraph 5 of amended petition.

5 (d). Denies the allegations of fact contained in subparagraph (d) of paragraphs 5 of amended petition.

Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore admitted, qualified or denied. [36]

WHEREFORE, it is prayed that petitioner's appeal be denied.

(Signed) ROBERT H. JACKSON
Assistant General Counsel
for the
Bureau of Internal Revenue.

Of Counsel:
I. GRAFF,
Special Attorney,
Bureau of Internal Revenue.
ikc 10-19-34. [37]

[Title of Court and Cause.]

MOTION TO CONSOLIDATE.

WHEREAS the above entitled cases involve the same issues;

NOW, THEREFORE, It is moved by the attorneys for the Petitioner, Thomas R. Dempsey and A. Calder Mackay, that these cases be consolidated for hearing and decision.

Dated this 7th day of June, 1934.

(s) THOMAS R. DEMPSEY
(s) A. CALDER MACKAY
Counsel for Petitioner
1104 Pacific Mutual Building,
Los Angeles, California.

Granted June 13, 1934:

(s) JED C. ADAMS
Member U. S. Board of Tax Appeals.

[Endorsed]: U. S. B. T. A. Filed at hearing June 13, 1934. [38]

[Title of Court and Cause—Docket Nos. 52987, 62979.]

FINDINGS OF FACT AND OPINION.

Promulgated August 29, 1935.

1. Where in 1918 the petitioner sold shares of stock in an oil company and the purchaser agreed to acquire all of the company's assets and dissolve it, and to develop and operate the oil properties and pay petitioner one third of

the net profits resulting therefrom, and in March 1926 petitioner orally agreed to assign his right to receive these profits to his wife and on August 4, 1926, notified the operating company of such assignment and directed the company in writing to make all future payments to his wife, held that petitioner's right to receive such profits was thereby completely assigned to his wife and the income thereafter paid by the operating company to the wife belonged to her and was not taxable to the petitioner.

2. Payments made to petitioner in 1925 and in 1926 up to August 4 of that year are taxable income to him and he is entitled to reduce such payments by the 27½ percent depletion provided under section 204 (c) (2), Revenue Act of 1926. Petitioner, by reason of his right to receive one third of the profits from oil production of the operating company, received as consideration for his stock in the company owning the oil properties, possessed such an economic interest in the property as entitles him to depletion.

Thomas R. Dempsey, Esq., and A. Calder Mackay, Esq., for the petitioner.

I. Graff, Esq., for the respondent.

These consolidated cases involve deficiencies in income tax as follows: 1924, $335.57; 1925, $505.59; 1926, $3,966.54; 1927, $7,003.28; 1928, $5,392.81; and 1929, $979.41. No evidence relative to the year 1924 was introduced and respondent's determination as

to the deficiency of $335.57 for that year is approved.

As to the remaining years, petitioner alleges that the income in question came from the development and operation of oil and gas wells in which he had an economic interest and that respondent erroneously refused to allow him depletion under section 204 (c) (2), Revenue Act of 1926, for the year 1925, and for the period from January 1, 1926, to August 4, 1926. [39]

Petitioner claims that on August 4, 1926, he assigned his property interest in the right to receive the income in question to his wife, and from that date through the remaining taxable years the income belonged to and was paid to his wife, who returned it for taxation, but it is alleged that notwithstanding this assignment the respondent erroneously included the income arising from the oil properties in petitioner's income and determined deficiencies thereon without allowing depletion.

Petitioner further alleges as an alternative that in the event it is decided that respondent properly included the income paid to his wife under the contract in his taxable income, he is entitled to depletion thereon under section 204 (c) (2), Revenue Act of 1926, and section 114 (b) (3), Revenue Act of 1928.

The facts were established by evidence given by deposition and by written stipulation, from which we make the following findings of fact.

FINDINGS OF FACT.

The petitioner, Thomas A. O'Donnell, and Winifred W. O'Donnell were married in December, 1925, and lived together as husband and wife in California during the taxable years. Petitioner was in the oil and gas production business and at the times in controversy was considered a person of substantial wealth. Among his holdings had been one third of the issued and outstanding capital stock of the San Gabriel Petroleum Co., which he sold to the Petroleum Midway Co., Ltd., by written contract of January 9, 1918. The contract was filed with the stipulation of facts as an exhibit. By the terms of the contract it was provided that the purchaser, as owner of all of the stock of the San Gabriel Petroleum Co., would acquire all of its assets and then dissolve it. The contract further provided:

> Second party agrees to purchase, and does hereby purchase, all of said first party's stockholdings in said San Gabriel Petroleum Company, and agrees to pay therefor, at the times and in the manner hereinafter specified, one-third (1/3) of the net profits received by it, its successors or assigns, from the development and operation of the properties described and enumerated in the leases, contracts and agreements now owned by said San Gabriel Petroleum Company, for and during the full, unexpired term or terms of said leases, contracts and agreements, and each of them.

In accordance with the contract the Petroleum Midway Co., Ltd. (name since changed to California Petroleum Corporation of California), acquired

all of the assets of San Gabriel Petroleum Co. and dissolved it, and developed and operated the oil properties thus acquired and paid petitioner one third of the net profits from the [40] date of the contract to August 4, 1926. Payments to petitioner in 1925 were $50,270.02 and in 1926 were $12,842.48. Desiring to provide a separate private income for his wife and make suitable provision for her maintenance and support, petitioner in March 1926 told her that he would give her his interest, income, or rights under the San Gabriel Petroleum Co. contract. He does not remember the exact words he used, but his purpose was to make her a gift of his entire interest in the San Gabriel contract and it was to be irrevocable. The question of diminishing his income tax was not considered and was not the moving cause of the gift and assignment. About the same time he made his will, making other provisions for his wife, but the San Gabriel contract was not mentioned therein.

On or about August 4, 1926, the petitioner delivered to the operating company a document which was in words and figures as follows:

Thos. A. O'Donnell
906 Security Building,
Los Angeles

August 4, 1926.

California Petroleum Corporation of Calif.
Security Building,
Los Angeles, California.

Gentlemen:

Please be advised that the income accruing to me in connection with the San Gabriel Petro-

leum Company agreement has been transferred as of March 31, 1926, to Mrs. Thos. A. O'Donnell, to whom you will make all future payments.

Yours very truly,

[Signed] THOS. A. O'DONNELL.

Genor:

Pls. send statements and checks to my office same as in the past.

[Signed] C. H. N.

The C H N above referred to was C. H. Norton, authorized agent of Mrs. O'Donnell.

Between August 4, 1926, and March 11, 1929, petitioner's wife received payments made by the company pursuant to the terms of said agreement in the following amounts:

1926	$15,535.85
1927	27,069.99
1928	21,451.24
1929	4,080.95

The respondent has included in petitioner's income, as shown in the deficiency notices, all of the above amounts received by petitioner's wife during the years 1926, 1927, 1928, and 1929, and no deductions for depletion have been allowed.

All of the payments to Mrs. O'Donnell were sent first to C. H. Norton, her authorized agent. Norton deposited the checks in bank [41] to the credit of Mrs. O'Donnell, who had the exclusive use and ownership thereof and used it for her own purposes, and reported it for taxation on her own separate income tax returns. Petitioner did not receive any

of the income after August 4, 1926, and did not have any right to or use of the bank account, nor did he subsequently exercise control over the contract or its proceeds in any way.

The assets taken over by the Petroleum Midway Co., Ltd., included oil and gas leases, and all the payments to petitioner and to his wife were made from profits derived from the production and sale of oil, gas and other hydrocarbon substances produced from the properties covered by the leases.

OPINION.

BLACK: The respondent does not question the good faith of the parties, contending that it is merely a question of law as to which party is taxable upon the sums received. It is the contention of the respondent that the mere transfer or assignment of income to be acquired in the future without the transfer or assignment of the contract from which the right to the income arises is not sufficient to relieve the assignor (petitioner) from liability for income tax thereon.

On the other hand, the petitioner contends that the only beneficial interest arising under the contract after the sale of his interest in the San Gabriel Petroleum Co. properties was the right to receive one third of the net profits from the development and operation of those properties; that this right was a property right, which was assignable either with or without the contract itself; and that subsequent income therefrom was not taxable to the petitioner.

In the case of William Ernest Seatree, 25 B. T. A. 396, we said:

> It is well settled that an assignment of income does not relieve the assignor of the tax thereon, but that if property or property rights are assigned the income subsequently arising therefrom is not taxable to the assignor, for the reason that the property no longer belongs to him and therefore the income from such property belongs, not to him, but to the new owner. [Citing cases.]

This is the general rule established by the decisions of this Board and the courts, but the difficulty arises in its application. Walter L. Ross, 30 B. T. A. 496. In the Seatree case, supra, the petitioner was entitled under articles of partnership to receive amounts equal to four shares of the firm's profits for a period of three years after his retirement from the firm. He executed a written instrument under seal by which "in consideration of the sum of one dollar, the receipt whereof is duly acknowledged and other good and valuable considerations" he transferred and assigned to the Equitable Trust Co. [42] of New York, in trust for his two minor daughters, "all my rights, title and interest in and to four undivided shares of the profits or income now due or which may hereafter become due and payable to me for three years ending June 30, 1924, under and by virtue of the partnership agreements." On these facts we held that Seatree's interest was in the nature of a capital asset; that the above quoted assignment transferred not merely future income,

but a present property right; and that income subsequently arising therefrom was not taxable to the petitioner, William Ernest Seatree. Our decision was affirmed by the United States Court of Appeals for the District of Columbia, 72 Fed. (2d) 67.

So it is, we think, in the instant case. Looking to the testimony of petitioner, we find that it is replete with statements which show that it was his intention to give to Mrs. O'Donnell not only the income itself, but also the right to receive the income, which right petitioner considered to be a valuable property.

Petitioner gave his wife the means of obtaining possession and control of the thing given in the only manner possible, by informing the California Petroleum Corporation that he had transferred the income accruing to him under said contract to his wife, and directing the company to make all future payments to her. The gift, having once been made, is irrevocable by the donor. Section 1148 of the Civil Code of California provides: "A gift, other than a gift in view of death, cannot be revoked by the giver."

It is the well established rule that delivery of a gift can be made by the donor to a third person for the benefit of the donee, 22 A. L. R. 765, and cases therein cited. When the petitioner gave the company the letter informing it that all of petitioner's rights were assigned to his wife and directed it to make all future payments to his wife, he made a delivery of the corpus of the gift to her; he gave her the means of obtaining possession and control

of the gift, and the gift was thereby completed. From the moment the company received that letter from the petitioner the petitioner could not direct the payment of such income to any person other than his wife; neither could he, by any legal action, compel the company to pay the income to him. Once the gift was completed, by enabling his wife to obtain possession and control of the right to receive the income, his dominion over the disposition of his former share of the profits terminated.

On this issue we hold for petitioner. Cf. Nelson v. Ferguson, 56 Fed. (2d) 121; Walter L. Ross, 30 B. T. A. 496; J. M. Kessler, 31 B. T. A. 849; Copland v. Commissioner, 41 Fed. (2d) 501; Lowery v. Helvering, 70 Fed. (2d) 713. [43]

Whether petitioner is entitled to a depletion allowance against the amounts received by him in 1925 and 1926 under his contract with the Petroleum Midway Co. Ltd., depends upon whether he had an economic interest in the oil in place within the meaning of the decision of the Supreme Court in Palmer v. Bender, 287 U. S. 551. Petitioner relies upon this case in support of his claim for depletion.

As has been pointed out in our findings of fact, when petitioner sold his stock in the San Gabriel Petroleum Co. to the Petroleum Midway Co. Ltd., the consideration was that the San Gabriel Co. was to be dissolved and its oil properties were to be transferred to the Petroleum Midway Co. and operated by it, and petitioner was to receive one third of the profits from such operation. Also in our findings of fact we have found that all the payments

here in question made to petitioner in 1925 and up to August 4, 1926, were made from profits derived from the production and sale of oil, gas, and other hydrocarbon substances produced from the properties formerly owned by the San Gabriel Co. In Signal Gasoline Corporation v. Commissioner, 66 Fed. (2d) 886, the court discussed the meaning and application of the Supreme Court's decision in Palmer v. Bender, supra, and, among other things, said:

> In that decision the court pointed out that the statute here involved permits a reasonable depletion allowance to be made "in the case of oil and gas wells * * * according to the peculiar conditions in each case"; that there is nothing in the statute or regulations to confine a depletion allowance to persons who are technical lessors; and that the concluding sentence of the section, to the effect that, in the case of leases, deductions shall be equitably apportioned between lessor and lessee, indicates that depletion deductions may be allowed in other cases. The court expressed the opinion that the language of the statute is broad enough to permit a depletion allowance in every case where a taxpayer had acquired, by investment, any interest in the oil in place, and acquires, by any form of legal relationship, income derived from the extraction of the oil, to which the taxpayer must look for a return of his capital. The court also stated that the right to a depletion allowance does not depend upon the retention of ownership or special form of legal interest in the min-

eral content of the land, but upon his right to share in the oil produced. In short, the court made it clear that the lessor, lessee, or any other person having or acquiring an interest in the oil in place or a right to share in the oil produced, has such an economic interest in the oil that he is entitled to a depletion allowance.

Accordingly, the right to a depletion allowance does not depend upon the nature or character of the legal estate retained or acquired by the parties to an original oil and gas lease or their successors, but depends entirely upon whether any such parties are entitled to share in the oil and gas produced from the properties. If any of such parties are entitled to a share of the oil and gas, he had the "economic interest" upon which the Supreme Court bases the right to a depletion allowance.

We think that petitioner, by virtue of his right to receive one third of the net profits from the oil produced from the San Gabriel prop- [44] erties, brings himself within the rules above announced and is entitled to the percentage depletion allowed by the applicable statute. On this issue we hold for petitioner. Cf. W. S. Green, 26 B. T. A. 1017; Chester Addison Jones, 31 B. T. A. 55; William Fleming, 31 B. T. A. 623.

Decision will be entered under Rule 50.

[Seal] [45]

United States Board of Tax Appeals.
Washington.

Docket Nos. 52987, 62979.

THOMAS A. O'DONNELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ORDER VACATING DECISION AND DECISION.

For cause appearing of record, it is

ORDERED: That the decision of the Board entered November 1, 1935, be and the same hereby is vacated and set aside, and further,

Pursuant to the Findings of Fact and Opinion of the Board, promulgated August 29, 1935, the respondent herein having on October 11, 1935, filed a recomputation of tax and the petitioner having on October 29, 1935, filed an acquiescence in said recomputation, now therefore, it is

ORDERED AND DECIDED: That there are overpayments in income tax for the years 1925, 1926 and 1927, in the respective amounts of $2,950.47, $800.35 and $3,003.28; and for the years 1924 and 1928, there are deficiencies in income tax in the respective amounts of $335.57 and $30.00; and that

there is no deficiency in income tax for the year 1929.

[Seal] (s) EUGENE BLACK,
Member.

Entered Nov. 5, 1935. [46]

In the United States Circuit Court of Appeals for the Ninth Circuit.

Nos. 52987, 62979.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

vs.

THOMAS A. O'DONNELL,

Respondent.

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

NOW COMES Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Frank J. Wideman, Assistant Attorney General, Herman Oliphant, General Counsel for the Department of the Treasury, and Frank M. Thompson, Jr., Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

The petitioner on review, hereafter referred to as the Commissioner, is the duly appointed, qualified and acting Commissioner of Internal Revenue of

the United States, holding his office by virtue of the laws of the United States. The respondent on review, hereafter referred to as the taxpayer, is a citizen of the United States and an inhabitant of Los Angeles, California, and filed his income tax returns for the years in question in the office of the Collector of Internal Revenue, at Los Angeles, California, which office is within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit. [47]

II.

The Commissioner determined deficiencies in income tax against the taxpayer for the years 1924, 1925, 1926, 1927, 1928 and 1929 in the respective amounts of $335.57, $505.59, $3,966.54, $7,003.28, $5,392.81 and $979.41, and on December 22, 1930 and January 21, 1932, in accordance with the provisions of Section 274 of the Revenue Act of 1926 and Section 272 of the Revenue Act of 1928, sent to the taxpayer by registered mail notices of said deficiencies. Thereafter, on February 19, 1931 and on March 18, 1932, the taxpayer filed appeals from said notices of deficiencies with the United States Board of Tax Appeals, the appeal filed on February 19, 1931 covering the taxable years 1924, 1925, 1926 and 1927, and the appeal filed on March 18, 1932 covering the years 1928 and 1929. The two appeals were consolidated for hearing and decision and the hearing before the Board on said appeals was held on June 5, 1934. On August 29, 1935 the Board promulgated its opinion and on November 5, 1935 entered its final order of redetermination in said appeals wherein and whereby the Board ordered

and decided that there are over assessments in income tax for the years 1925, 1926, and 1927 in the respective amounts of $2,950.47, $800.35, and $3,003.28; for the years 1924 and 1928 there are deficiencies in income tax in the respective amounts of $335.57 and $30.00; and that there is no deficiency in income tax for the year 1929.

III.

The taxpayer and his wife, Winifred W. O'Donnell, were married in December, 1925 and lived together as husband and wife during the taxable years. The taxpayer was in the oil and gas production business. In 1918 he had acquired a contract under which he had the right to receive one-third of the net profits resulting from the operation of certain oil [48] properties. Before the Board he contended that he not only gave the income under that contract to his wife in 1926 but also the contract from which the income arises. He also contended before the Board that he had the right to deduct depletion with respect to the payments received by him under the above-mentioned contract prior to this assignment to his wife in 1926. The Commissioner had included in the taxpayer's income for all the years involved the profits received under the contract. He had also allowed no deduction from income on account of depletion in connection with the properties covered by the contract.

The Board held for the taxpayer on both issues, finding, contrary to the contentions of the Commissioner, that the taxpayer had effected an absolute

surrender to his wife of the very right to the income and that the nature of the taxpayer's property was a contract right to receive one-third of the net profits resulting from the operation of the property which gave him an economic interest in the oil in place and entitled him to percentage depletion against the income received by him under the contract. No evidence relative to the year 1924 was introduced before the Board and the Commissioner's determination as to the deficiency for that year was approved.

IV.

The Commissioner says that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and decision rendered and entered by said Board manifest error occurred and intervened to the prejudice of the Commissioner and the Commissioner assigns the following errors and each of them which he avers occurred in the said [49] record, proceedings, opinion and decision upon which he relies to reverse the said opinion and decision so rendered and entered by the United States Board of Tax Appeals, to wit:

1. In finding that the taxpayer's purpose was to make an irrevocable gift to his wife of his entire interest in his contract with Petroleum Midway Company, Ltd.

2. In permitting the introduction of testimony as to whether the taxpayer exercised control over his contract with Petroleum Midway Company, Ltd., after August 4, 1926.

3. In finding that the taxpayer did not exercise control over said contract after August 4, 1926.

4. In refusing to exclude testimony as to whether the taxpayer exercised control over said contract after August 4, 1926.

5. In holding that the taxpayer assigned to his wife not only the income from said contract but also the contract itself, or the right to receive the income thereunder.

6. In failing to hold that the taxpayer did not assign to his wife said contract or the right to receive the income thereunder.

7. In holding that the taxpayer made a gift of said contract or the right to receive the income thereunder to his wife.

8. In failing to hold that the taxpayer made no gift of said contract or of the right to receive the income thereunder to his wife.

9. In holding that the payments made under said contract between August 4, 1926 and March 11, 1929 did not constitute taxable income to the taxpayer. [50]

10. In failing to hold that the payments made under said contract between said dates constituted taxable income to the taxpayer.

11. In holding that the taxpayer was entitled to a depletion allowance against the amounts received by him in 1925 and 1926 under said contract.

12. In failing to hold that the taxpayer was not entitled to a depletion allowance against the amounts received by him in 1925 and 1926 under said contract.

13. In redetermining the taxpayer's liability and deciding that there are overassessments for the years 1925, 1926 and 1927 in the amounts of $2,950.47, $800.35, and $3,003. 28 respectively, a deficiency of $30.00 for the year 1928, and no deficiency for the year 1929.

14. In failing to approve the deficiencies in tax for the years 1925 to 1929, inclusive, as determined by the Commissioner.

15. In not rendering judgment for the Commissioner for the reason that any other judgment was not supported by competent and substantial evidence, nor according to law.

WHEREFORE, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with law and with the rules of said court, and transmitted to the Clerk of said Court for filing and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Signed) FRANK J. WIDEMAN
Assistant Attorney General
(Signed) HERMAN OLIPHANT
General Counsel for the
Department of the Treasury.

Of Counsel:
FRANK M. THOMPSON, Jr.
Special Attorney,
Bureau of Internal Revenue. [51]

United States of America
District of Columbia—ss.

Frank M. Thompson, Jr., being duly sworn, says that he is a special attorney in the office of the Assistant General Counsel for the Bureau of Internal Revenue, and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to matters therein alleged on information and belief, and as to those matters he believes it to be true.

(s) FRANK M. THOMPSON, JR.

Sworn and subscribed to before me this 22nd day of Jan. 1936.

(s) GEORGE W. KREIS,
Notary Public.

My commission expires Nov. 16, 1937.

[Endorsed]: U.S.B.T.A. Filed Jan. 22, 1936. [52]

[Title of Court and Cause—Nos. 52987, 62979.]

NOTICE OF FILING PETITION FOR REVIEW.

To: Thomas A. O'Donnell,
906 Security Building,
Los Angeles, California.

Thomas R. Dempsey,
1104 Pacific Mutual Building,
Los Angeles, California.

You are hereby notified that the Commissioner of Internal Revenue did on the 22nd day of January, 1936, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Board heretofore rendered in the above-entitled cases. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 22nd day of January, 1936.

(Signed) HERMAN OLIPHANT,
General Counsel for the
Department of the Treasury.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 27th day of Jan., 1936.

(Sgd.) THOMAS A. O'DONNELL,
Respondent on Review.

(Sgd.) THOMAS R. DEMPSEY,
Attorney for Respondent on Review.

[Endorsed]: U. S. B. T. A. Filed Feb. 5, 1936. [53]

[Title of Court and Cause.—Docket Nos. 52987, 62979.]

STATEMENT OF EVIDENCE.

The evidence in this case was presented to the Honorable Jed C. Adams, Member of the United States Board of Tax Appeals, at Beverly Hills, California, on June 5, 1934, at which time Thomas R. Dempsey appeared on behalf of the taxpayer and I. Graff appeared on behalf of the Commissioner of Internal Revenue. A stipulation of facts, with an agreement between T. A. O'Donnell and Petroleum Midway Company, Ltd., dated January 9, 1918 attached, and marked Exhibit "A", was received in evidence. The depositions of Thomas A. O'Donnell and Mrs. Thomas A. O'Donnell, taken before Grace Summers, Notary Public, on May 17, 1934, in Los Angeles, California, were also offered and received in evidence. The testimony of

THOMAS A. O'DONNELL,

as given in the deposition is as follows:

My name is Thomas A. O'Donnell, business address, 906 Security Building, Los Angeles, California. In addition to the delivery of the document dated August 4, 1926, referred to in Division V of the stipulation, to the California Petroleum Corporation, in connection with [54] making the transfer to Mrs. O'Donnell, I can't say I did anything about the terms of the lease that were carried out by the parties to whom it was addressed. I had considerable conversation with her. I don't know

(Deposition of Thomas A. O'Donnell.)

at this late date, what words I used. I can give you the substance. With this explanation, we hadn't been married very long, and had just gotten home and I had made out a will and brought it home and showed her a copy of it. At that time I told her I had turned over to her one of the most substantial properties I had for her personal income. That was along in March, sometime. The will was made on March 19th, 1926, and the conversation I had with my wife was to the effect that I was not only providing for her in my will but I was turning over to her for her personal use, a valuable income which was part of my wealth. At that time I hadn't yet written the letter to the Petroleum Midway, although I had told her that I was doing that.

In my conversation with her I referred to the agreement dated January 9, 1918, between me and the Petroleum Midway Company, Ltd., as a substantial piece of property which wholly consisted of income. I couldn't be positive just what I said, what the conversation was. The purpose of it was to assure her that I was preparing and was then turning over to her a valuable more or less permanent income. My purpose in turning it over to her was, at that time I was considered a person of substantial wealth; Mrs. O'Donnell was not and I thought she was entitled to a personal income in which she wouldn't have to ask me at all times for spending money or whatever she wanted to use it for. [55]

(Deposition of Thomas A. O'Donnell.)

It was my intention that the rights which I had under this contract be transferred to Mrs. O'Donnell as her sole and separate property."

"I have not, to my knowledge, received one cent of the payments made by the Petroleum Midway Company under and in pursuance of the agreement of January 9, 1918 since the date of the delivery of the document bearing date of August 4, 1926 referred to in paragraph V of the stipulation of facts.

The following question was asked by counsel to which objection was made and overruled and exception taken:

> "Have you, since August 4, 1926, exercised any control over the subject of the contract of January 9th, 1918, aforesaid?"

The reply of the witness was:

> "I have had no control over it. Shall I make an explanation there?"

Continuing from that point, Mr. O'Donnell then testified as follows:

I had no right to and have not, since August 4th, 1926, directed the Petroleum Midway Company, Limited, as to any matter under that contract. I don't remember signing any document addressed to the Petroleum Midway Company, Limited, since August 4th, 1926, in reference to the contract. [56]

Cross Examination.

I had no agreement before marriage with my wife as to property settlement. After marriage, I had

(Deposition of Thomas A. O'Donnell.)

no agreement with her as to property settlement except the will that I made, that I showed her, and this gift. My purpose in making the agreement of August 4, 1926, was to provide her with an income where she would feel free to do with it as she pleased, without asking me for funds. I am convinced that that was my one and only purpose. At the time that was what I was thinking about anyway. I don't believe that I had in my mind at the time the question of the effect of the income from this contract on my individual income taxes. I was making a will and giving her a piece of property. I will say this, if there had been no income tax, I would have done just what I did. Prior to this time I attempted to assign the income from this contract to a trust. I made a trust for two beneficiaries I was obligated to take care of. That was revocable.

As to the reason for the delay in executing the agreement, from March, 1926, when I discussed it with my wife, to August 4, 1926, when it was executed, we were living down at Palm Springs and I can't tell you any more than I was up here and made my will and took it back and discussed this proposition with her and the next time I was in town I sent this letter which seemed to me to be conclusive and irrevocable on my part without her consent. I discussed turning over to her a separate income property, producing a separate income in

(Deposition of Thomas A. O'Donnell.)
the form of this contract. I mentioned the property or where it was coming from. I can't repeat exact words on [57] hardly any subject that long ago, largely because of my health, my memory is not as good as it was, but I am quite positive in the general purpose that I had well in mind, I had made additional provisions for my wife in my will. There was no understanding between me and my wife after the letter of August 4, 1926, that she was not to share in any of my other property.

The testimony of

MRS. WINIFRED W. O'DONNELL,

as given in the deposition is as follows:

My name is Winifred W. O'Donnell; my address is 2300 East Ocean Boulevard, Long Beach, and in Palm Springs. My business address is 906 Security Building, Los Angeles. I am the wife of Thomas A. O'Donnell. We were married in December, 1925. I knew of the letter of August 4th, 1926, referred to, at the time it was given. When Mr. O'Donnell and I first came back from Washington, after we had been married, he first came to the office and when he came back to Palm Springs from the office he brought a copy of a new will he had drawn, for me to read and he said "I have made arrangements that in the future the income from the San Gabriel lease should be paid—I give you—is to be

(Deposition of Mrs. Winifred W. O'Donnell.)

paid to you for your separate personal income." That was some time along in February or March. I didn't impress the time on my mind, but it was the first time he came to the office after we had gotten back from the east.

I received the amount of $15,358.85 paid by the Petroleum Midway Company, Limited, in 1926, after August 4, 1926, and in 1926. The checks made by the Petroleum Midway Company, Ltd., covering the amounts stipulated, have been made payable to me and were deposited by Mr. Norton to my credit in the [58] Farmers and Merchants Bank. No one other than myself has had at any time or has the right to draw checks on that account.

The note in ink appended at the bottom of the original document dated August 4, 1926, reading "Genor: Please send statements and checks to my office same as in the past—C. H. N", is in Mr. Norton's handwriting.

Mr. Norton is the one who has always transacted all business affairs for me following my marriage to Mr. O'Donnell, and he was the one who was requested to deposit these checks to my credit, so I asked Mr. Norton to take care of these matters for me.

My direction to him to take care of certain business matters for me was made after my marriage to Mr. O'Donnell and prior to August 4, 1926. Mr. Norton received the checks for me and deposited them in my account.

(Deposition of Mrs. Winifred W. O'Donnell.)

I understood from my conversation with Mr. O'Donnell with respect to his giving me this money, or the right to receive it, that it was to become my sole and separate property. The only change that I know of in the arrangement, as specified in the agreement of January 9th, 1918, since August 4th, 1926, is that the checks were paid each month and have been for some time, instead of quarterly.

The Texas Company is now developing this lease and there is no income at the present time to me. They are going into deeper sands. I was consulted about this development and signed a document in connection therewith during the year 1934. I have never paid over to Mr. O'Donnell any portion of the moneys received by me from the Petroleum Midway Company, Ltd., or its successor, or successors. In fact, he has given me additional money. All of the money I have received since August 4th, 1926, I have treated as my sole and separate property. [59]

Cross Examination.

I never had any agreement with my husband, after my marriage, as to any property settlement. We never had any discussion of financial matters whatever. That was the first time the question of what money I was to have or how my personal expenses should be taken care of—when Mr. O'Donnell came back from the office that time. It had never been discussed prior to my marriage with him.

(Deposition of Mrs. Winifred W. O'Donnell.)

From the time of my marriage Mr. Norton looked after everything for me, everything pertaining to me; I asked him to see that the taxes were paid on my home and everything pertaining to my little affairs was under his supervision. I don't know at whose direction the note at the bottom of the letter of August 4th, 1926 was written. I think Mr. Norton wrote it because he knew he was handling the depositing of that to my account. I couldn't say who told him to write it. I think he did that of his own accord.

As to how I utilized the payments received in 1926 to 1929, I paid my bills and I gave some to my mother who was dependent upon me at that time. I gave her some in an allowance and I used it. Mr. O'Donnell never questioned me. It was mine to use as I pleased and I used it just as you would check against any account.

At the time Mr. O'Donnell told me he was writing this letter to the Petroleum Midway Company, he said he was sending a letter to the Texas people to verify the transfer of this income to me, that he had instructed [60] that it be paid to me and he was writing this letter in verification of those instructions. That was to be my separate income and that letter was confirming that, making confirmation of the authority that had been done verbally.

Redirect Examination.

The Texas Company now operates these properties. They took the California Petroleum Corpora-

(Deposition of Mrs. Winifred W. O'Donnell.)

tion after 1929. The reference I made to the Texas Company meant either the California Petroleum Corporation or the Texas Company. Those two always operated the lease in my time.

I considered the transfer made by Mr. O'Donnell of the right under the contract as in the nature of a wedding present to me. It was made soon after I was married. At that time I had no property which produced income to me.

Recross Examination.

Nothing was mentioned by either Mr. O'Donnell or myself in those words that it was to be a wedding gift. He said he intended to take care of my future needs and give me a separate, independent income which I could use as I pleased. I always had my own income from my earnings before my marriage and that was his way of supplying that. It was the only wedding gift he gave me. It was his gift to me after our marriage. I refer to it as a wedding gift because it was given to me at the time of my marriage. [61]

MR. O'DONNELL

was recalled and testified on redirect examination as follows:

The agreement of the 9th day of January, 1918, referring to the San Gabriel Petroleum Company, is what is referred to in the letter of August 4th,

(Deposition of Mr. O'Donnell.)

1926. During the years 1926 to 1929 I was Chairman of the Board of the California Petroleum Corporation which was the successor company of the Petroleum Midway Company, the latter being the wholly owned subsidiary of the former. I always referred to the agreement of January 9th, 1918, as the San Gabriel lease and when asking anyone about it I used to ask how the San Gabriel property was. If I wanted to be technical about it I would refer to it as the San Gabriel Petroleum Company contract, but it was the San Gabriel leases I had in mind generally. In the letter of August 4, 1926, when the San Gabriel Petroleum Company agreement was referred to, I had in mind the agreement of January 9th, 1918. The California Petroleum Corporation of California so understood and made the payments as directed in the letter of August 4, 1926. I gave no other document or instructions to the California Petroleum Corporation of California.

Recross Examination.

The California Petroleum Corporation of California made payments of one-third of the net income under the San Gabriel leases. That net income was derived from the sale of oil. The property was producing oil in all of these years. Generally speaking the income from the leases was [62] from the production of oil. There might have been some kind of equipment put on and which in one year they had charged to cost and had gotten done with it

(Deposition of Mr. O'Donnell.)

and moved it off and sold it to somebody, which would be part of the income. There would not be any profit in such sale of equipment, but a loss. The entire income here was from the sale of oil.

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, Herman Oliphant, General Counsel for the Department of the Treasury, as attorney for the Commissioner of Internal Revenue.

(Signed) HERMAN OLIPHANT,
General Counsel for the
Department of the Treasury.

The foregoing is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, as attorney for the respondent on review.

(Sgd.) THOMAS R. DEMPSEY,
Attorney for Respondent
on Review.

The foregoing is all of the material evidence adduced at the hearing and in order that the same may be preserved and made a part of the record, this statement of evidence is duly approved and settled this 14th day of April, 1936.

(s) EUGENE BLACK,
Member, United States Board
of Tax Appeals.

[Endorsed]: U. S. B. T. A. Lodged Apr. 11, 1936. Filed Apr. 14, 1936. [63]

United States Board of Tax Appeals.

Docket Nos. 52987 and 62979.

THOMAS A. O'DONNELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION OF FACTS.

It is hereby stipulated by and between the parties hereto, through their respective counsel, that:

I.

On or about the 9th day of January, 1918, the Petitioner entered into a written agreement with the Petroleum Midway Company, Ltd. (sometimes referred to herein as the "Company"), a true copy of which is hereunto attached, marked Exhibit A and made a part hereof. (The name of said Company has since been changed to "California Petroleum Corporation of California.")

II.

The Petitioner in pursuance of the said agreement transferred one-third of the issued and outstanding stock of the San Gabriel Petroleum Company to the Company. By reason of such transfer and prior transfers by other stockholders of the San Gabriel Petroleum Company to the Company, it became the

owner of all the issued and outstanding capital stock of San Gabriel Petroleum Company. [64]

III.

Prior to any of the taxable years herein involved the Company acquired from the San Gabriel Petroleum Company all of its assets, rights and properties and caused the said San Gabriel Petroleum Company to be dissolved and disincorporated.

IV.

Petitioner received certain payments made by the Company under and in pursuance of the terms of said agreement in the amounts and during the years as follows:

Year	Amount
1925	$50,270.02
1926	12,842.48

The above amounts were included in Petitioner's income tax returns for their respective years of receipt and have been included in the net income as shown in the Respondent's deficiency letters covering said years and no deductions for depletion have been allowed.

V.

On or about August 4, 1926, the Petitioner delivered to the Company a document which was in words and figures as follows:

"Thos. A. O'Donnell
906 Security Building,
Los Angeles August 4, 1926.
California Petroleum Corporation of Calif.,
Security Building,
Los Angeles, California.
Gentlemen:

Please be advised that the income accruing to me in connection with the San Gabriel Petroleum Company agreement has been. transferred as of March 31, 1926 to Mrs. Thos. A. O'Donnell, to whom you will make all future payments. [65]

Yours very truly,
THOS. A. O'DONNELL (Signed)

Genor:

Pls. send statements and checks to my office same as in the past;

(Signed) C H N

VI.

Between August 4, 1926 and March 11, 1929, Petitioner's wife received certain payments made by the Company under and in pursuance of the terms of said agreement in the amounts and during the years as follows:

Year	Amount
1926	$15,535.85
1927	27,069.99
1928	21,451.24
1929	4,080.95

The Respondent has included in Petitioner's income, as shown in the deficiency letters attached to the respective petitions in the above entitled cases, all of the above amounts received by Petitioner's wife during the years 1926, 1927, 1928 and 1929, and no deductions for depletion have been allowed.

VII.

The assets taken over by the Company from San Gabriel Petroleum Company included certain oil and gas leases. The payments enumerated in paragraphs IV and VI above were made from profits (as defined in said agreement) derived by the Company from the production and sale of oil, gas and other hydrocarbon substances from the properties covered by said oil and gas leases.

VIII.

Petitioner's wife, Mrs. Thomas A. O'Donnell, filed separate income tax returns for each of the years 1926 to 1929, both inclusive. [66]

IX.

In 1927 Petitioner received income from salaries in the amount of $62,368.24, all of which the Respondent included in Petitioner's net income for the year 1927 as shown in the deficiency letter for that year. The Petitioner is entitled to treat $25,986.77 of the said income as community income and is therefore entitled to an additional deduction from

net income as shown by the deficiency letter amounting to $12,993.38.

Dated this 17th day of May, 1934.

THOMAS R. DEMPSEY,
Counsel for Petitioner.
ROBERT H. JACKSON,
Counsel for Respondent. [67]

EXHIBIT A.

AGREEMENT, Made and entered into this 9th day of January 1918, by and between T. A. O'DONNELL, hereinafter called first party, and PETROLEUM MIDWAY COMPANY, LTD., a corporation, hereinafter called second party.

WHEREAS, First party is the owner of one-third (1/3) of the issued and outstanding stock of the SAN GABRIEL PETROLEUM COMPANY, a corporation; and

WHEREAS, First party has offered to sell the same to second party for one-third (1/3) of the net profits resulting from the development and operation of the properties described and enumerated in the leases, contracts and agreements now owned by said San Gabriel Petroleum Company, and second party desires to accept said offer to sell said property; and

WHEREAS, it is the purpose and intent of second party, as owner of all the issued and outstanding capital stock of said San Gabriel Petroleum Company, to acquire all of its assets and to bring about its dissolution and dis-incorporation;

NOW THEREFORE, For and in consideration of the mutual promises and covenants hereinafter contained, the parties hereto agree as follows:

(a) First party hereby agrees to sell, assign, transfer and set over, and does by these presents sell, assign, transfer and set over unto the second party, his entire stockholdings in the said San Gabriel Petroleum Company for and in consideration of the payment by second party of one-third (1/3) of the net profits received by second party from the development and operation of the properties described and enumerated in the leases, contracts and agreements now owned by said San Gabriel Petroleum Company, for and during the full, unexpired term or terms of said leases, contracts and agreements, and each of them.

(b) Second party agrees to purchase, and does hereby purchase, all of said first party's stockholdings in said San Gabriel Petroleum Company, and agrees to pay therefor, at the times and in the manner hereinafter specified, one-third (1/3) of the net profits received by it, its successors or assigns, from the development and operation of the properties described and enumerated in the leases, contracts and agreements now owned by said San Gabriel Petroleum Company, for and during the full, unexpired term or terms of said leases, contracts and agreements, and each of them. [68]

Second party further agrees to furnish such sum or sums of money as may be necessary to pay the debts of said San Gabriel Petroleum Company, and

to pay the same, and to furnish such sum or sums of money as may from time to time be necessary to carry on the development of the said properties now owned by said San Gabriel Petroleum Company.

Second party further agrees to comply with all the terms and conditions of the various leases, contracts and agreements now owned by said San Gabriel Petroleum Company, and to do and perform each and all such acts and things as may be necessary to protect said leases, contracts and agreements from cancellation or forfeiture.

Second party further agrees to acquire from said San Gabriel Petroleum Company all its assets, rights and properties, and to dissolve and disincorporate said company.

And it is further understood and agreed, by and between the parties hereto, that the net profits received by second party from the development and operation of said leasehold interests and properties shall be ascertained and determined quarterly, for quarters ending respectively on March 31, June 30th, September 30th, and December 31st, of each year, and in ascertaining and determining same, there shall be deducted from the gross receipts, in addition to other deductions, a sum of money equal to six (6%) per cent per annum, figured on the net advances made by second party for the payment of the debts of said San Gabriel Petroleum Company and for the development of its properties, and when the net profits have so been ascertained, one-third

(1/3) thereof shall be paid over to first party within Twenty (20) days next succeeding the end of each quarter.

IN WITNESS WHEREOF, the parties hereto have executed this agreement in triplicate the day and year first above written.

(Signed) THOS. A. O'DONNELL,
PETROLEUM MIDWAY
COMPANY, LTD.
By I. W. FUQUA,
Pres.
By NORMAN BRIDGE,
Secy.

[Endorsed]: U. S. B. T. A. Filed at hearing June 5, 1934. [69]

In the United States Circuit Court of Appeals for the Ninth Circuit.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

vs.

THOMAS A. O'DONNELL,

Respondent.

PRAECIPE FOR RECORD.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Board of Tax Ap-

peals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board,
   (a) Petitions, including attached notices of deficiencies.
   (b) Answers.
   (c) Amended petitions.
   (d) Answers to amended petitions.
   (e) Motion and order to consolidate.
3. Findings of fact, opinion and final decision of the Board.
4. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.
5. Statement of the evidence as settled and allowed.
6. Stipulation of facts filed June 5, 1934, with copy of agreement dated January 9, 1918, attached, marked "Exhibit A". [70]
7. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record. [Not included in record.]

8. This praecipe.

(Signed) HERMAN OLIPHANT,
General Counsel for the
Department of the Treasury.

Service of a copy of the within praecipe is hereby admitted this 6th day of April, 1936.

(Sgd.) THOMAS R. DEMPSEY,
Attorney for Respondent.

ike 3-2-36

[Endorsed]: U. S. B. T. A. Filed Apr. 11, 1936. [71]

United States Board of Tax Appeals, Washington.

Docket Nos. 52987, 62979.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

.....

Respondent.

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 71, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of

Tax Appeals, at Washington, in the District of Columbia, this 27th day of April, 1936.

[Seal] B. D. GAMBLE,
Clerk, United States
Board of Tax Appeals.

[Endorsed]: No. 8186. United States Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Thomas A. O'Donnell, Respondent. Transcript of the record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed May 1, 1936.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 8186

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THOMAS A. O'DONNELL, RESPONDENT

Proceedings had in the United States Circuit Court of Appeals for the Ninth Circuit.

Excerpt from Proceedings of Wednesday, March 3, 1937

Before WILBUR, MATHEWS, and HANEY, Circuit Judges

Order of submission

Ordered petition to review in above cause argued by Mr. A. F. Prescott, Special Assistant to the Attorney General, counsel for petitioner, and by Mr. A. Calder Mackay, counsel for respondent, and submitted to the court for consideration and decision.

Excerpt from Proceedings of Monday, June 14, 1937

Before WILBUR, GARRECHT, and MATHEWS, Circuit Judges

Order directing filing of opinion and filing and recording of judgment

By direction of the court, ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the Clerk, and a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 8186. June 14, 1937

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THOMAS A. O'DONNELL, RESPONDENT

Upon Petition to Review a Decision of the United States Board of Tax Appeals

Before WILBUR, MATHEWS, and HANEY, Circuit Judges

MATHEWS, *Circuit Judge:* Upon auditing respondent's income tax returns for 1925, 1926, 1927, 1928, and 1929, the Commissioner of

Internal Revenue determined that there were deficiencies in the respective amounts of $505.59, $3,966.54, $7,003.28, $5,392.81, and $979.41, and so notified respondent. Respondent petitioned the Board of Tax Appeals for redetermination of the alleged deficiencies. The Board decided that, instead of deficiencies, there were overpayments of respondent's income tax for 1925, 1926, and 1927 in the respective amounts of $2,950.44, $800.35, and $3,003.28; that for 1928 there was a deficiency of $30 only, and that for 1929 there was neither a deficiency nor an overpayment. The Commissioner seeks reversal of the Board's decision.

Facts found by the Board and not disputed by the Commissioner are as follows:

On and prior to January 9, 1918, respondent was the owner and holder of one-third of all the issued and outstanding capital stock of the San Gabriel Petroleum Company, a corporation, hereafter called San Gabriel, by which certain oil properties were held under lease. Respondent on that date sold and transferred all his San Gabriel stock to the Petroleum Midway Company, Ltd., a corporation, hereafter called Midway, by a written contract, hereafter called the San Gabriel contract, which provided that Midway would acquire all of San Gabriel's assets, including its oil leases, pay all its debts and then dissolve it. The contract further provided:

"Second party (Midway) agrees to purchase, and does hereby purchase, all of said first party's (respondent's) stockholdings in (San Gabriel), and agree to pay therefor, at the times and in the manner hereinafter specified, one third (⅓) of the net profits received by it, its successors or assigns, from the development and operation of the properties described and enumerated in the leases, contracts, and agreements now owned by (San Gabriel), for and during the full, unexpired term or terms of said leases, contracts, and agreements, and each of them.

"And it is further understood and agreed, by and between the parties hereto, that the net profits received by second party from the development and operation of said leasehold interests and properties shall be ascertained and determined quarterly, for quarters ending respectively on March 31, June 30th, September 30th, and December 31st, of each year, and in ascertaining and determining same, there shall be deducted from the gross receipts, in addition to other deductions, a sum of money equal to six (6%) per cent per annum, figured on the net advances made by second party for the payment of the debts of (San Gabriel) and for the development of its properties, and when the net profits have so been ascertained, one-third (⅓) thereof shall be paid over to first party within Twenty (20) days next succeeding the end of each quarter."

The right to receive one-third of the net profits from the development and operation of the leased properties therein referred to was the only right which the contract vested or purported to vest in respondent.

In accordance with the contract, Midway acquired all of San Gabriel's assets, including its oil leases, paid all its debts and then dissolved it. Thereafter Midway developed and operated the oil properties covered by the leases and paid respondent one-third of its net profits therefrom, from the date of the contract to August 4, 1926. Payments so made to respondent in 1925 were $50,270.02, and in 1926 were $12,842.48. For each of those years respondent claimed an allowance for depletion. His claim was rejected by the Commissioner, but was sustained by the Board.

Respondent was married in December 1925. Desiring to provide a separate private income for his wife and to make suitable provision for her maintenance and support, respondent in March 1926, told her that he would give her his interest, income, or rights under the San Gabriel contract. He does not remember the exact words he used, but his purpose was to make her an irrevocable gift.

On August 4, 1926, respondent wrote and delivered to Midway a letter reading as follows:

"Please be advised that the income accruing to me in connection with the San Gabriel (contract) has been transferred as of March 31, 1926, to Mrs. Thos. A. O'Donnell (respondent's wife), to whom you will make all future payments."

Thereafter respondent exercised no control over the San Gabriel contract and received no payments thereunder. All payments subsequently accruing under the contract were made to respondent's wife. Payments so made to her in 1926, 1927, 1928, and 1929 were in the respective amounts of $15,535.85, $27,069.99, $21,451.24, and $4,080.95. These sums were received by her agent, C. H. Norton, who deposited them in a bank to her credit. She had the exclusive use, ownership, and control of this money, used it for her own purposes and, in separate returns filed by her, reported it for taxation as her separate income. The Commissioner ruled that the money so paid to respondent's wife was taxable income of respondent. The Board reversed that ruling.

The Commissioner filed, with his petition for review, fifteen assignments of error. Eight of the assigned errors (assignments 2, 3, 4, 6, 7, 8, 10, and 12) are not specified in the Commissioner's brief, as required by our Rule 24, and are therefore disregarded. Mutual Life Ins. Co. v. Wells Fargo Bank & Union Trust Co. (C. C. A. 9), 86 F. (2d) 585, 587; Hultman v. Tevis (C. C. A. 9), 82 F. (2d) 940, 941.

The remaining assignments raise two questions: (1) Whether respondent was entitled to a depletion allowance for 1925 and 1926, and (2) whether the payments made to respondent's wife in 1926, 1927, 1928, and 1929 constituted taxable income of respondent.

Section 214 (a) of the Revenue Act of 1924, 43 Stat. 269, 270, provides:

"In computing net income there shall be allowed as deductions:

* * * * * * *

"(9) In the case of mines, oil, and gas wells, * * * a reasonable allowance for depletion * * *, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee."

Similar provisions are found in Sec. 214 (a) of the Revenue Act of 1926, 44 Stat. 26, 27.

The Commissioner concedes that, if in 1925 and 1926. before making the gift to his wife, respondent had an economic interest in the oil in place in the leased properties mentioned in the San Gabriel contract, he was entitled to a depletion allowance under Sec. 214 (a) of the Revenue Acts of 1924 and 1926, but contends that respondent had no such interest and was, therefore, not entitled to a depletion allowance for those years. This contention must be rejected. One who is entitled, as respondent was, to receive from the holder of an oil lease a third of the net profit from the development and operation of the oil property covered by the lease cannot be said to have no economic interest in the oil in place in such leased property. Commissioner v. Elliott Petroleum Corp. (C. C. A. 9), 82 F. (2d) 193, 194, and cases there cited. See, also, Obispo Oil Co. v. Welch (C. C. A. 9), 85 F. (2d) 860, reversed on other grounds in — U. S. —; Bankline Oil Co. v. Commissioner (C. C. A. 9), — F. (2d) —, decided ——, 1937.

As to the second question, the Commissioner concedes that respondent intended to and did make his wife an irrevocable gift of all income accruing to him under the San Gabriel contract after August 4, 1926, but challenges the Board's finding that respondent intended to give his wife his entire interest in the contract. The Board's finding is amply supported by the evidence. Respondent testified:

"I had considerable conversation with (my wife). I don't know, at this late date, what words I used. I can give you the substance. With this explanation, we hadn't been married very long, and had just gotten home and I had made out a will and brought it home and showed her a copy of it. At that time I told her I had turned over to her one of the most substantial properties I had for her personal income. That was along in March, sometime. The will was made on March 19th, 1926, and the conversation I had with my wife was to the effect that I was not only providing for her in my will, but I was turning over to her, for her personal use, a valuable income which was part of my wealth. At that time I hadn't yet written the letter to (Midway), although I had told her that I was doing that.

"In my conversation with her I referred to the agreement dated January 9, 1918, between me and (Midway), as a substantial piece

of property which wholly consisted of income. I couldn't be positive just what I said, what the conversation was. The purpose of it was to assure her that I was preparing and was then turning over to her a valuable more or less permanent income. My purpose in turning it over to her was, at that time I was considered a person of substantial wealth; Mrs. O'Donnell (respondent's wife) was not, and I thought she was entitled to a personal income in which she wouldn't have to ask me at all times for spending money or whatever she wanted to use it for.

"It was my intention that the rights which I had under this contract be transferred to Mrs. O'Donnell as her sole and separate property."

The only right or interest respondent ever had in or under the contract was the right to receive one-third of the net profits from the development and operation of the oil properties mentioned therein. This right, according to his testimony, he intended to give to his wife. If so, he intended to give her his entire interest in the contract. The Board's finding to that effect, being supported by substantial evidence, is conclusive on this court. Holmby Corp. v. Commissioner (C. C. A. 9), 83 F. (2d) 548, 549; Commissioner v. Bank of California (C. C. A. 9), 80 F. (2d) 389, 390; Commissioner v. Eldridge (C. C. A. 9), 79 F. (2d) 629, 630; Commissioner v. Gerard (C. C. A. 9), 75 F. (2d) 542, 544. It thus conclusively appears that respondent intended to give his wife everything he had in or under the San Gabriel contract, retaining nothing therein or thereunder for himself.

It is true the mere intention, or the mere expression of it to respondent's wife, was not sufficient to complete the gift. As stated in the Commissioner's brief, "something remained to be done", but that "something" was done when respondent wrote and delivered to Midway his letter of August 4, 1926, directing that all subsequent payments under the contract be made to his wife. The Board's opinion correctly states:

"Petitioner (respondent here) gave his wife the means of obtaining possession and control of the thing given in the only manner possible, by informing (Midway) that he had transferred the income accruing to him under said contract to his wife, and directly (Midway) to make all future payments to her. * * *

"* * * When the petitioner gave (Midway) the letter informing it that all of petitioner's rights were assigned to his wife and directed it to make all future payments to his wife, he made a delivery of the corpus of the gift to her; he gave her the means of obtaining possession and control of the gift, and the gift was thereby completed * * *."

Respondent having transferred to his wife his entire interest in the property—the San Gabriel contract—which produced the income here involved, all income subsequently arising therefrom was taxable, not to him, but to his wife. Blair v. Commissioner, 300 U. S. 5, 12; Hall v. Burnet (App. D. C.), 54 F. (2d) 443, 444; Helvering v. Seatree (App. D. C.), 72 F. (2d) 67, 68; Commissioner v. Field

(C. C. A. 2), 42 F. (2d) 820, 822; Lowery v. Helvering (C. C. A. 2), 70 F. (2d) 713, 714; Copland v. Commissioner (C. C. A. 7), 41 F. (2d) 501, 504.

Cases cited by the Commissioner are readily distinguishable. In Lucas v. Earl, 281 U. S. 111, the taxpayer, an attorney at law, had made an agreement with his wife whereby his future earnings were to be received and owned by them jointly. Daugherty v. Commissioner (C. C. A. 9), 63 F. (2d) 77, involved a similar agreement. In Corliss v. Bowers, 281 U. S. 376, the taxpayer had transferred a fund to trustees, in trust, to pay the income to his wife, but had reserved to himself power to alter or abolish the trust at will. In Burnet v. Leininger, 285 U. S. 136, the taxpayer, a member of a partnership, had assigned future partnership income to his wife. The partnership continued as before, the respondent being a member, the wife not. In Ward v. Commissioner (C. C. A. 9), 58 F. (2d) 757, the taxpayer, being the holder of a 99-year lease, sublet the leased property and assigned to his wife the rentals payable to him by his sublessees, but did not assign the lease itself or all his rights thereunder. These cases, therefore, are not in point.

Decision affirmed.

(Endorsed:) Opinion. Filed June 14, 1937. Paul P. O'Brien, Clerk.

No. 8186

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THOMAS A. O'DONNELL, RESPONDENT

Judgment

Upon Petition to Review a Decision of the United States Board of Tax Appeals.

This Cause came on to be heard on the Transcript of the Record from the United States Board of Tax Appeals and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Board of Tax Appeals in this Cause be, and hereby is affirmed.

(Endorsed:) Judgment. Filed and entered June 14, 1937. Paul P. O'Brien, Clerk.

No. 8186

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THOMAS A. O'DONNELL, RESPONDENT

Certificate of Clerk, U. S. Circuit Court of Appeals for the Ninth Circuit, to record certified under Rule 38 of the Revised Rules of the Supreme Court of the United States

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing ninety-three (93) pages, numbered from and including 1 to and including 93, to be a full, true, and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of the Hon. Stanley Reed, Solicitor General of the United States, of counsel for the petitioner, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 31st day of August A. D. 1937.

PAUL P. O'BRIEN, *Clerk.*

U. S. GOVERNMENT PRINTING OFFICE: 1937

Supreme Court of the United States

Order allowing certiorari

Filed October 25, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted, and the case is assigned for argument immediately following Nos. 387 and 388.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 1937

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14689—37

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THOMAS A. O'DONNELL

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit entered in this cause on June 14, 1937.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 47–52) is reported in 32 B. T. A. 1277. The opinion of the Circuit Court of Appeals is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 14, 1937. The jurisdiction of

this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether one acquires a depletable interest when he sells his stock in one corporation to another which "agrees to pay therefor * * * one-third (⅓) of the *net profits* received by it * * * from the development and operation" of oil leases, which the purchaser corporation agrees to acquire from the first corporation.

STATUTE INVOLVED

The statute involved will be found in the Appendix, *infra,* pp. 7–8.

STATEMENT

Thomas A. O'Donnell, an oil operator, owned one-third of the capital stock of the San Gabriel Petroleum Company, which he sold to the Petroleum Midway Company, Ltd., by written contract on January 9, 1918. (R. 44.)

As consideration for such stock Midway agreed to pay O'Donnell one-third of the *net profits* from the development and operation of the properties enumerated in leases then owned by the San Gabriel Company. (R. 78.) Midway agreed to acquire all of the assets of the San Gabriel Company and to dissolve it. (R. 79.)

The contract further provided that in ascertaining net profits, which was to be done quarterly, "there shall be deducted from the gross receipts, in

addition to other deductions, a sum of money equal to six (6%) per cent per annum" figured on the net advances made by the Midway Company for the payment of the debts of the San Gabriel Company and for the development of its properties. (R. 79.)

In accordance with the contract, the Midway Company (name since changed to California Petroleum Corporation of California) acquired all of the assets of the San Gabriel Company and dissolved it, and developed and operated the oil properties thus acquired, and paid respondent one-third of the net profits to August 4, 1926. (R. 44–45.) (Subsequent payments were made to Mrs. O'Donnell (R. 46), which the court below held were taxable to her.)

The petition to the Board involved O'Donnell's right to deduct percentage depletion on the payments received by him under the above contract. (R. 22.) The Board allowed the claimed depletion. The Circuit Court of Appeals affirmed the Board.

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the taxpayer, under his contract with the Midway Company, acquired an economic interest in oil in place.

2. The Circuit Court of Appeals erred in holding that the taxpayer was entitled to a 27½% depletion allowance on the payments he received under his contract with the Midway Company.

REASONS FOR GRANTING THE WRIT

1. In holding that the respondent acquired an economic interest in oil in place, the Circuit Court of Appeals improperly extended and misapplied the decision of this Court in *Palmer* v. *Bender,* 287 U. S. 551. In the *Palmer* case this Court held that one who had retained the right to share in the *oil* produced from an oil well had an economic interest in the oil in place, subject to depletion.

Prior to the transfer of his stock, the taxpayer had no economic interest in the oil in place, but only a right to receive dividends from the profits derived by the corporation from the leases. The instant case is, therefore, unlike *Palmer* v. *Bender, supra,* and *Thomas* v. *Perkins,* decided June 1, 1937, No. 824, October Term, 1936, where the assignors had previously been lessees and transferred their rights to others, retaining an interest in the production.

The taxpayer did not acquire an economic interest in the oil in place by the transfer of his stock, but only the right to share in the *net profits* from the operation of the properties.[1] He acquired neither the right to share in kind in the oil produced and saved, as in *Palmer* v. *Bender, supra,* nor a right to receive the value in cash of a speci-

[1] The Circuit Court of Appeals said: "The only right or interest respondent ever had in or under the contract was the right to receive one-third of the net profits from the development and operation of the oil properties * * *."

fied proportion of the oil, as in *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312, 321, nor a right to receive a specified amount out of the gross proceeds of the oil, as in *Thomas* v. *Perkins, supra.* His only interest was a right under the contract to receive a specified proportion of Midway's net profits, if any, from operation of the oil leases, to be determined by deducting from gross receipts not only operating expenses but the stipulated interest payments as well. Such an interest cannot be said to constitute that *ownership* either of the oil produced or of the gross proceeds of the oil which under the statute is essential.

In *Thomas* v. *Perkins, supra,* this Court in discussing the *Palmer* case said:

> Thus in that case we held assignors' mere stipulation for royalty out of oil operated to save to them an economic interest in the *oil* sufficient to entitle them to deduct from their income derived from the oil an allowance for depletion. If Palmer had retained no interest in the oil he would have been entitled to no deduction on account of depletion. *Ownership was essential.* [Italics supplied.]

The Court pointed out that there is no difference, so far as ownership is concerned, between percentage and cost depletion.

The depletion allowance is a percentage of "gross income." "Gross income" from the property means gross receipts from the oil extracted.

Helvering v. *Twin Bell Syndicate, supra.* Ownership of the oil is essential to determine whose is the gross income, since the ownership of gross income determines the right to the depletion allowance. In the instant case Midway owned the oil produced. To it belonged the gross proceeds from the sale of the oil. These proceeds O'Donnell cannot in any sense be said to have owned. The amounts payable to him were part of Midway's net income.

2. The question is of considerable importance. Many cases are now pending involving this or similar questions. Continued misapplication of the *Palmer* decision endangers the revenues in large sums, for depletion erroneously allowed to one may rightfully be claimed by another.

Petition for certiorari has heretofore been filed in *Helvering* v. *Bankline Oil Co.*, No. 387, October Term, 1937, involving a closely related question.

CONCLUSION

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

STANLEY REED,
Solicitor General.

SEPTEMBER 1937.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 916, 26:

SEC. 204. * * *

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made

under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * *

U. S. GOVERNMENT PRINTING OFFICE : 1937

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 406

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THOMAS A. O'DONNELL

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 47–52) is reported in 32 B. T. A. 1277. The opinion of the Circuit Court of Appeals (R. 85–90) is reported in 90 F. (2d) 907.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 14, 1937 (R. 90). Petition for certiorari was filed September 11, 1937, and was granted October 25, 1937. The jurisdiction of this

Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether one acquires a depletable interest when he sells his stock in one corporation to another which "agrees to pay therefor * * * one-third (⅓) of the *net profits* received by it * * * from the development and operation" of oil leases, which the purchaser corporation agrees to acquire from the first corporation.

STATUTE INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9, 16, 26:

> SEC. 204. * * *
>
> (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—
>
> * * * * * *
>
> (2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if

computed without reference to this paragraph.

SEC. 214 (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * *

STATEMENT

Thomas A. O'Donnell, an oil operator, owned one-third of the capital stock of the San Gabriel Petroleum Company, which he sold to the Petroleum Midway Company, Ltd., by written contract on January 9, 1918 (R. 44).

As consideration for such stock Midway agreed to pay O'Donnell one-third of the *net profits* from the development and operation of the properties enumerated in leases then owned by the San Gabriel Company (R. 78). Midway agreed to acquire all of the assets of the San Gabriel Company and to dissolve it (R. 79).

The contract further provided that in ascertaining net profits, which was to be done quarterly, "there shall be deducted from the gross receipts, in addition to other deductions, a sum of money equal to six (6%) per cent per annum" figured on the net advances made by the Midway Company for the payment of the debts of the San Gabriel Company and for the development of its properties (R. 79).

In accordance with the contract, the Midway Company (name since changed to California Petroleum Corporation of California) acquired all of the assets of the San Gabriel Company and dissolved it, and developed and operated the oil properties thus acquired, and paid respondent one-third of the net profits to August 4, 1926 (R. 44–45). (Subsequent payments were made to Mrs. O'Donnell (R. 46), which the court below held were taxable to her.)

The petition to the Board involved O'Donnell's right to deduct percentage depletion on the payments received by him under the above contract during the years 1925 and 1926 (R. 22). The Board allowed the claimed depletion. The Circuit Court of Appeals affirmed the Board.

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the taxpayer, under his contract with the Midway Company, acquired an economic interest in oil in place.

2. The Circuit Court of Appeals erred in holding that the taxpayer was entitled to a 27½% depletion allowance on the payments he received under his contract with the Midway Company.

SUMMARY OF ARGUMENT

I. The depletion allowance is a percentage of "gross income from the property." Only the owners of oil or gas as produced, or of the gross proceeds thereof, receive gross income from the property and are entitled to participate in the allowance. *Palmer* v. *Bender,* 287 U. S. 551; *Thomas* v. *Perkins,* 301 U. S. 655. In the instant case Midway owned the oil produced. To it belonged the gross proceeds from the sale of the oil. The respondent's interest in the oil in place, or in the oil produced, was no greater—indeed, was less—than if he had been a stockholder in Midway entitled to receive dividends pursuant to a special formula. Midway, which owned the oil produced, was solely entitled as against the respondent to the depletion allowance.

II. The respondent was not only without any interest in the oil but also without interest in the leases or in the lands. The transaction with Midway was a sale of stock in consideration of Midway's promise to pay an indeterminate sum of money, and was so treated by the taxpayer in an earlier litigation. It was not an exchange of property. *Burnet* v. *Logan,* 283 U. S. 404. An agree-

ment to pay over a share of *net* profits from the operation of an oil lease is not an interest in the lease or the land but is a mere personal covenant. The taxpayer, having no capital interest whatsoever in the property is clearly outside the class of "mines, oil and gas wells, other natural deposits and timber" to which the depletion section alone applies.

ARGUMENT

This case is one of four, to be heard consecutively,[1] dealing with related problems concerning the right of a taxpayer under the Revenue Acts of 1926 and 1928 to share in the deduction for percentage depletion granted by the statutes "in the case of * * * oil and gas wells."

In the present case the respondent acquired, in consideration of the sale of shares of corporate stock, the right to receive a specified proportion of the purchaser's net profits, as specially defined in the contract, from the development and operation of certain oil leases which the purchaser agreed to acquire. The court below, we think, erred in holding that sums paid pursuant to this contract are subject to depletion.

---

[1] The other three are No. 387 (*Helvering* v. *Bankline Oil Co.*), No. 446 (*Helvering* v. *Elbe Oil Land Development Co.*), and No. 600 (*Helvering* v. *Mountain Producers Corp.*).

I

THE TAXPAYER, SINCE HE DID NOT OWN THE OIL AS PRODUCED, OR ITS PROCEEDS, DID NOT RECEIVE "GROSS INCOME FROM THE PROPERTY"

The depletion allowance is granted to compensate the taxpayer for the wasting of a capital asset incident to the production of taxable income. An interest in the mineral in place—a capital asset—is therefore a prerequisite of the allowance. This interest, however, need not amount to legal ownership of the mineral content of the land. What is essential is that the taxpayer be entitled to a share of the mineral produced, or of its gross proceeds. *Palmer* v. *Bender,* 287 U. S. 551; *Helvering* v. *Twin Bell Oil Syndicate,* 293 U. S. 312; *Thomas* v. *Perkins,* 301 U. S. 655. "If so, he has an economic interest in the oil, in place, which is depleted by production." *Palmer* v. *Bender,* 287 U. S. at 557. It is only owners of gas and oil, *as produced,* who are recipients of "gross income from the property" within the meaning of the statute, and hence entitled to depletion. *Thomas* v. *Perkins,* 301 U. S. at 661.

The court below, relying upon the phrase just quoted from this Court's opinion in *Palmer* v. *Bender, supra,* held that the taxpayer had "an economic interest in the oil in place" since extraction of oil was the ultimate source of the payments, if any, to be made by Midway; and that this interest sufficed to entitled him to participate in the deple-

tion allowance. We think that the court gave to the phrase a meaning not justified by the context in which it was used. The opinion in *Palmer* v. *Bender* was directed to the contention that an assignor of an oil lease who under local law had retained no technical reversionary interest was without that interest in the oil in place which is essential to depletion. The Court held that the right, which the assignors retained, to share in the oil produced constituted an economic interest in the oil in place "which represented their capital investment and was subject to depletion," and that the circumstance, if such it was, that "legal ownership of it [the oil in place], in a technical sense, remained in their lessor" was without significance.

The Court's holding that the right to depletion does not depend upon the precise nature of legal ownership of the oil and gas in place emphasizes, rather than detracts from, its insistence upon the necessity of ownership of the mineral (or its proceeds) as produced. For the one criterion was rejected in favor of the other. The nature of the rights of parties to oil and gas leases in the oil and gas in place is the subject of much conflict and confusion in the holdings of state courts. Federal tax law, the Court held, was not intended to turn upon the niceties of these decisions. The criterion of the right to ownership of the mineral as produced, on the other hand, is subject to no such uncertainties. This element, moreover, the law has always regarded as of cardinal significance. It is everywhere

recognized that the owner even of the fee of oil or gas bearing lands has only a qualified ownership of the minerals in the earth, because of their fugitive nature, which does not become absolute until they are reduced to possession. Thompson, *The Modern Law of Real Property,* Vol. 6, Sec. 5131; Thornton, *The Law of Oil and Gas* (5th ed.), Vol. 1, Secs. 35, 37. The Court held that the existence of this essential right to possession determines the right to depletion; and supported this conclusion by the statement that one who is thus entitled to the oil produced has a capital investment subject to depletion in an economic, whether or not in a legal, sense. Such a holding is a far cry from the proposition that any economic advantage arising out of a contract with an oil and gas operator and depending ultimately upon operation of the well constitutes a depletable interest in the oil and gas in place.

The necessity, under the ruling in *Palmer* v. *Bender,* of ownership of the oil as produced is made clear in this Court's discussion of that case in *Thomas* v. *Perkins, supra,* 301 U. S. at 661:

> Thus in that case we held assignors' mere stipulation for royalty out of *oil* operated to save to them an economic interest in the *oil* sufficient to entitle them to deduct from their income derived from the oil an allowance for depletion. If Palmer had retained no interest in the oil he would have been entitled to no deduction on account of depletion. *Ownership was essential.* (Italics supplied.)

In the instant case Midway owned the oil produced. To it belonged the gross proceeds from the sale of the oil. By the transfer of his stock the respondent acquired neither the right to share in kind in the oil produced and saved, as in *Palmer* v. *Bender, supra,* nor a right to receive the value in cash of a specified portion of the oil, as in *Helvering* v. *Twin Bell Oil Syndicate, supra*; nor a right to receive a specified amount out of the gross proceeds of the oil, as in *Thomas* v. *Perkins, supra.* His only interest was a right under the contract to receive a specified proportion of Midway's net profits, if any, from operation of the oil leases, to be determined by deducting from its gross receipts not only operating expenses but the stipulated interest payments as well. The respondent's interest in the oil in place, or in the oil produced, was no greater than if he had been a stockholder with an agreement by which dividends were to be declared pursuant to a special formula. Indeed, his interest was less, since his only right was one in current income plus a right to damages in the event of abandonment of the leases by Midway in violation of the agreement (R. 79).

Respondent's "economic interest in the oil," under any view of the phrase, was thus at best contingent and remote. The existence of net profits was dependent upon a congeries of factors beyond his control, in addition to the mere extraction of

oil. The property might be operated to the point of exhaustion without any substantial payments to him. In these circumstances we think it impossible to say that O'Donnell owned the oil or that he received income *from the property*—much less *gross* income from the property—within the meaning of the statute.

We submit that *Helvering* v. *Twin Bell Oil Syndicate, supra,* is a controlling authority that Midway, as against O'Donnell, was entitled to the whole of the depletion allowance. In that case the taxpayer, who operated the property, claimed that the gross proceeds of all the oil produced should furnish the basis for his depletion allowance, without subtraction of the proceeds of royalty oil paid over to the lessor. The Court ruled, however, that the basis for percentage depletion is limited to 100 per cent of "gross income" from the property; that lessors having a right to gross proceeds of a part of the oil produced received "gross income from the property" within the meaning of the statute and were entitled to share in the allowance; and that respondent could deduct only "27½ per cent of the gross income from production which it had the right to retain" (293 U. S. at 321). In the instant case Midway is entitled as against the taxpayer to retain the whole of the gross income, and no basis exists, therefore, for denying it the whole of the depletion allowance.

II

THE TAXPAYER ACQUIRED NO CAPITAL INTEREST OF ANY CHARACTER IN THE PROPERTY

In the petitioner's view the circumstance that the taxpayer had no rights in the oil as produced, or in its proceeds, is decisive against his claim to depletion. Hence he would have no depletable interest even if he were an assignor, entitled to a share of his assignee's net profits. The taxpayer, however, was not only without any interest in the oil but also without interest in the leases or in the lands.

Prior to the transfer of his stock, the taxpayer, of course, had no interest in the lands or leases. He had only a right to receive dividends, if dividends were declared from the profits, if any, of the San Gabriel corporation. The only question therefore concerns the nature of the interest which he *acquired* in the transaction with Midway. This transaction, we think, was a sale of stock by O'Donnell to Midway in consideration of the latter's promise to pay an indeterminate sum of money. It was not an exchange of property. At the time of the transaction, indeed, Midway itself did not own the leases.

The transaction is not distinguishable from that considered in *Burnet* v. *Logan,* 283 U. S. 404. There stock was transferred for cash and a proportionate share of 60 cents per ton of ore apportioned to the purchaser. It was contended that

the receipts under the contract should each year be apportioned to capital and income. This Court said (pp. 412–413):

> The * * * transaction was a sale of stock—not an exchange of property. We are not dealing with royalties or deductions from gross income because of depletion of mining property. * * * As annual payments on account of extracted ore come in they can readily be apportioned first as return of capital and later as profit. * * * She [taxpayer] properly demanded the return of her capital investment before assessment of any taxable profit * * *.

That the present transaction was a sale is a necessary implication from the taxpayer's own contention in a previous litigation. There O'Donnell made the claim that his receipts in 1923 under the present contract constituted a return of capital; and the claim was denied on the ground that the cost of the stock transferred was not in excess of the amounts already received by him prior to 1923. *O'Donnell* v. *Commissioner*, 64 F. (2d) 634, certiorari denied, 290 U. S. 699; S. C., 25 B. T. A. 956, 962. Had the transaction constituted an exchange of the stock for a depletable interest in the oil in place, O'Donnell of course could have made no such claim. The necessity for return of capital before recognition of income imports a sale. It is repugnant to the theory of depletion.

O'Donnell's previous position that the transaction was a sale rather than an exchange was correct,

unless a contract giving the right to a share in net profits resulting from the operation of oil leases creates an interest in the property. Plainly it does not. O'Donnell, of course, acquired no profit *a prendre;* he had no right to go upon the premises to extract the mineral. Compare *Southwest Pipe Line Co.* v. *Empire Natural Gas Co.,* 33 F. (2d) 248, 252 (C. C. A. 8th), 64 A. L. R. 1229; *Richfield Oil Co.* v. *Hercules Gasoline Co.,* 112 Cal. App. 431; Thornton, *Law of Oil and Gas,* Vol. I, p. 148. Midway's promise of a share of its net profits is not a covenant running with the land. Compare *Consolidated Arizona Smelting Co.* v. *Hinchman,* 212 Fed. 813 (C. C. A. 1st), certiorari denied, 239 U. S. 640. Since O'Donnell was an entire stranger to the lease, the payments cannot under any view be regarded as rent. Nor is the promise one to deliver a share of the product of the land, entitling O'Donnell to ownership either of the mineral as produced or of its proceeds. The court below held (R. 89):

> The only right or interest respondent ever had in or under the contract was the right to receive one-third of the net profits from the development and operation of the oil properties.

Such an agreement to pay over a share of *net* profits is not an interest in the lease or the land but is a mere personal covenant. Mills and Willingham, *Law of Oil and Gas,* pp. 184–185:

> An "overriding royalty" is a given percentage of the *gross* production payable to some person other than the lessor or persons

> claiming under him. * * * The provision creates in the owner of such royalty an interest in the lease, cannot be transferred or surrendered except with the same formalities necessary for a transfer of the lease, * * *.
>
> But an agreement to deliver a share of the *net* production, to someone other than the lessor or his assigns, * * * is not a true overriding royalty, is not an interest in the lease or the land, but is a mere personal covenant * * *.

The taxpayer, therefore, had no property interest whatever, either in the land or in the leases or in the oil itself as produced, which was susceptible of depletion. Even assuming that Midway's promise had a market value when given, so that it might have been treated as a capital asset (as to which there is no showing in the record), the statutes afford no justification for regarding a mere personal promise as a depletable interest. Nor do the decisions of this Court furnish any precedent for the anomaly of participation in the depletion allowance by one who under general as well as local law is without any interest in the *property* which is being depleted.[2] O'Donnell, we submit, is clearly outside the class of "mines, oil and gas wells, other natural deposits and timber," to which the depletion section alone applies.

---

[2] The taxpayer in *Palmer* v. *Bender*, *supra*, it should be noted, had under general law an interest in the lease, since he was entitled to share in the product of the land.

CONCLUSION

In view of the foregoing we respectfully submit that the decision of the Circuit Court of Appeals should be reversed.

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JANUARY 1938.

U. S. GOVERNMENT PRINTING OFFICE: 1938

FILE COPY

IN THE

SUPREME COURT

OF THE

UNITED STATES

October Term, 1937.

No. 406.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

THOMAS A. O'DONNELL,

ON PETITION FOR A WRIT OF CERTIORARI TO THE [illegible] CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION

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IN THE

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OCTOBER TERM, 1937.

No. 406.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

THOMAS A. O'DONNELL,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

Opinions Below

The opinion of the Board of Tax Appeals [R. 47-52] is reported in 32 B. T. A. 1277. The opinion of the Circuit Court of Appeals is not yet reported.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered June 14, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented

Is a taxpayer, who is entitled to receive one-third of the net profits from the development and operation of oil properties, entitled to a deduction for depletion in computing his net taxable income?

Statutes Involved

The statutes involved will be found in the Appendix, *infra*, pp. 11, 12.

Statement of the Case

Thomas A. O'Donnell, an oil operator, owned one-third of the capital stock of the San Gabriel Petroleum Company, which he sold to the Petroleum Midway Company, Ltd., by written contract on January 9, 1918. [R. 44.]

As consideration for such stock Midway agreed to pay O'Donnell one-third of the net profits from the development and operation of the properties enumerated in leases then owned by the San Gabriel Company. [R. 78.] Midway agreed to acquire all of the assets of the San Gabriel Company and to dissolve it. [R. 79.]

The contract further provided that in ascertaining net profits, which was to be done quarterly, "there shall be deducted from the gross receipts, in addition to other deductions, a sum of money equal to six (6%) per cent per annum, figured on the net advances made by second party (Midway Company) for the payment of the debts of said San Gabriel Petroleum Company and for the development of its properties, * * *" [R. 79.]

In accordance with the contract, the Midway Company (name since changed to California Petroleum Corpora-

tion of California) acquired all of the assets of the San Gabriel Company and dissolved it, and developed and operated the oil properties thus acquired, and paid respondent one-third of the net profits to August 4, 1926. [R. 44-45.] (Subsequent payments were made to Mrs. O'Donnell [R. 46], which the court below held were taxable to her.)

The petition to the Board involved O'Donnell's right to deduct percentage depletion on the payments received by him under the above contract. [R. 22.] The Board allowed the claimed depletion. The Circuit Court of Appeals affirmed the Board.

Argument

Despite the Government's constant attempt to limit depletion allowances to only those owning legal title of the mineral lands, this Honorable Court has consistently held that the statutory allowance "is to be made to everyone whose property right and interest therein have been depleted by the extraction and disposition of the mineral." (*Lynch v. Alworth-Stephens Co.*, 267 U. S. 364.) Subsequent to this decision the Government took the position that "depletable interest" must be some form of estate in land, leasehold or freehold, as distinguished from contractual rights to receive payments measured by the production of oil. However, this Honorable Court following the doctrine laid down in the *Alworth-Stephens Co.* case held that the depletion deduction should be allowed to all those having an "economic interest" in the mineral pool.

Palmer v. Bender, 287 U. S. 551, 53 S. Ct. 225, 77 L. Ed. 489.

This Honorable Court has also held that a lessor was entitled to the depletion deduction on a bonus received prior to production (*Murphy Oil Company v. Burnet*, 287 U. S. 299, 53 S. Ct. 161, 77 L. Ed. 318); and also that a lessor is entitled to a depletion allowance on bonus and royalties although by the local law ownership of the minerals in place passes from the lessor upon the execution of the lease.

Burnet v. Harmel, 287 U. S. 103, 53 S. Ct. 74, 77 L. Ed. 199;

Bankers Pocahontas Coal Company v. Burnet, 287 U. S. 308, 53 S. Ct. 150, 77 L. Ed. 325.

Petitioner, nevertheless, contends that the respondent did not acquire an economic interest in the oil in place. The Board found that respondent sold capital stock of the San Gabriel Petroleum Company to the Petroleum Midway Company, Ltd. and the latter agreed to pay respondent one-third of the net profits received by it from the development and operation of the properties enumerated in the leases. [R. 78.] Respondent's right to receive one-third of the net profits from the development and operation of the properties was certainly an economic interest; it was a source from which respondent derived income. Respondent's right to receive any money depended upon production of oil. Certainly, the production of oil exhausted the oil pool and by such exhaustion respondent's property right was depleted. The mineral content certainly was an economic unit, one hundred per cent of which was owned by someone. The Petroleum Midway Company, Ltd. was entitled to only sixty-six and two-thirds per cent of the profits derived from production and respondent was entitled to the balance. Therefore, it is quite evident that

respondent had an economic interest in the mineral and that he is entitled to the depletion deduction.

Petitioner emphasizes the fact that in computing the net profits to be divided between respondent and the Petroleum Midway Company, Ltd. certain stipulated interest payments were to be deducted. The contract [R. 79] does provide that in determining the net profits "there shall be deducted from the gross receipts in addition to other deductions a sum equal to six per cent per annum, figured on the net advances made by second party for the payment of the debts of said San Gabriel Petroleum Company and for the development of its properties, * * *."

Under the contract of January 9, 1918, the Petroleum Midway Company, Ltd. agreed to acquire all the stock of the San Gabriel Petroleum Company and then dissolve it. Naturally, the creditors had to be taken care of and the stipulated interest deducted in determining the net profits from the proceeds was merely a *pro rata* share of respondent's liability as a stockholder. The deduction of interest charges on debts owed by the San Gabriel Petroleum Company as well as interest paid on money used by the Petroleum Midway Company, Ltd. in developing the properties cannot, it is respectfully submitted, change the fact that respondent had an economic interest in the mineral resources. His economic interest was merely diminished by the stipulated interest payments. Certainly the requirement that in determining the net proceeds the stipulated interest be deducted does not in anywise lessen the right respondent had in the mineral resources.

The interest which was to be deducted in determining the net profits was nothing more than additional cost to the respondent of his interest in the mineral resources.

Respondent's right is no different than his right would have been had the San Gabriel Petroleum Company distributed all of its assets in liquidation (which, of course, were oil properties), to its stockholders. The respondent was entitled to one-third of the assets. The result would have been the same if the San Gabriel Petroleum Company had been liquidated and respondent had transferred his one-third interest therein to the Petroleum Midway Company, Ltd. for the same consideration, a right to receive one-third of the net profits from production. In either event the respondent would have had the same economic interest in the oil properties.

Petitioner contends that the gross income from the property belonged to the Petroleum Midway Company, Ltd. by reason of which petitioner now alleges would deny respondent the right to depletion. This begs the question. Under the arrangement the Petroleum Midway Company, Ltd. was not the owner of all the gross proceeds derived from production; it merely had the right to operate the property and before dividing the proceeds to deduct stipulated interest and cost of operation. At all times respondent had an interest in the mineral products—in the gross proceeds—and the amount he was to receive was merely measured by the net proceeds. In any event the amount that respondent received was derived from the production of oil. The amount he received was his gross income and it is that gross income which the statute refers to in determining the amount of the depletion deduction.

The statute contemplates that the total amount of depletion allowed be apportioned between those entitled thereto. The Petroleum Midway Company, Ltd. certainly is not entitled to the full deduction for depletion since it does not

have an economic interest in the full amount derived from the production of oil. It has merely the right to sixty-six and two-thirds per cent, and certainly it would be highly inequitable to give Petroleum Midway Company, Ltd. all the depletion under these circumstances. The revenues of the Government will not be affected if petitioner will follow the requirements of the statute and the principles enunciated and reiterated by this Court on this question.

The mere fact that the contract provided that Midway Company was to pay respondent cash instead of oil does not in any wise change the nature of respondent's interest in the property. This Honorable Court stated in the case of *United States v. Noble,* 237 U. S. 73, 74, 59 L. Ed. 844, that:

> "* * * It is said that the leases contemplated the payment of sums of money, equal to the agreed percentage of the market value of the minerals, and thus that the assignment was of these moneys; but the fact that rent is to be paid in money *does not make it any the less a profit issuing out of the land.* * * *." (Italics supplied.)

This Honorable Court in the case of *Burnet v. Harmel,* 287 U. S. 103, 53 S. Ct. 74, 77 L. Ed. 199, also stated:

> "It is an incident of every oil and gas lease, where production operations are carried on by the lessee, that the ownership of the oil and gas passes from the lessor to the lessee at some time and the lessor is compensated by the payments made by the lessee for the rights and privileges which he acquires under the lease. * * *."

It would appear that anyone is economically interested in property who realizes proceeds from property or has a right, by whatever name called, to realize proceeds. Everyone beneficially interested in oil properties should have depletion on a percentage basis in direct proportion to their income from the property, and this right to depletion should not be denied or transferred to another person by reason of artificial technicalities affecting the title to the property.

Since there is no conflict in the Circuit Courts and since the rule applied by the Ninth Circuit Court of Appeals is in harmony with the decisions of this Honorable Court, there are no grounds for granting the writ. The petition should therefore be denied.

Respectfully submitted,

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APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 916:

SEC. 204. * * *

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * * * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

SEC. 214 (a) In computing net income there shall be allowed as deductions:

* * * * * * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * * * * * *

Revenue Act of 1928, c. 852, 45 Stat. 799:

SEC. 23. * * *

(1) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. (For percentage depletion in case of oil and gas wells, see section 114 (b) (3).)

* * * * * * * * *

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

October Term, 1937

No. 405

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

vs.

THOMAS A. O'DONNELL,

Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR THE RESPONDENT.

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

October Term, 1937

No. 406

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

THOMAS A. O'DONNELL,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR THE RESPONDENT.

Opinions Below.

The opinion of the Board of Tax Appeals [R. 47-52] is reported in 32 B. T. A. 1277, the opinion of the Circuit Court of Appeals [R. 85-90] in 90 F. (2d) 907.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered June 14, 1937 [R. 90]. Petition for writ of certiorari was filed September 11, 1937, and granted by order filed October 25, 1937. The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Is a taxpayer, having a right to share in the proceeds of oil production, to be denied depletion merely because his share of such proceeds is measured by the net profits rather than gross receipts from production?

Statutes Involved.

Set forth in the appendix, *infra,* pp. 19, 20.

Statement of the Case.

The respondent, Thomas A. O'Donnell, an oil operator, owned one-third of the capital stock of the San Gabriel Petroleum Company. He sold the aforesaid stock to the Petroleum Midway Company, Ltd. by written contract of January 9, 1918 [R. 44]. The contract is on file with the stipulation of facts as Exhibit "A" [R. 77-80]. The contract provided that the purchaser, as owner of all of the stock of San Gabriel Petroleum Company, would acquire all of its assets and then dissolve it [R. 44]. The contract further provided that:

> "Second party agrees to purchase, and does hereby purchase, all of said first party's stockholdings in said San Gabriel Petroleum Company, and agrees to pay therefor, at the times and in the manner hereinafter specified, one-third (⅓) of the net profits received by it, its successors or assigns, from the development and operation of the properties described and enumerated in the leases, contracts and agreements now owned by said San Gabriel Petroleum Company, for and during the full, unexpired term or terms of said leases, contracts and agreements, and each of them." [R. 44.]

Petroleum Midway Company, Ltd. agreed to furnish all money necessary for development and operation, to comply with all the terms and conditions of the various leases, contracts and agreements, and to do and perform each and all such acts and things as might be necessary to protect said leases, contracts and agreements from cancellation or forfeiture [R. 79].

In accordance with the contract Petroleum Midway Company, Ltd. (name since changed to California Petroleum Corporation of California) acquired all of the assets of San Gabriel Petroleum Company and dissolved it, and developed and operated the oil properties thus acquired and paid respondent one-third of the net profits so received from the date of contract to August 4, 1926 [R. 44-45]. Respondent received $50,270.02 in 1925 and $12,842.48 in 1926. (Subsequent payments were made to Mrs. O'Donnell, which the court below held were taxable to her.)

The assets taken over by the Petroleum Midway Company, Ltd. consisted of oil and gas leases, and all payments to respondent, and his wife thereafter, were made from profits derived from the sale of oil, gas and other hydrocarbon substances produced from the properties covered by the leases [R. 76].

The petitioner erroneously refused to allow the respondent a deduction for depletion sustained with respect to such payments so made entirely from profits derived from the sale of oil, gas and other hydrocarbon substances produced only from the properties covered by the leases.

The Board of Tax Appeals reversed the petitioner's determination and allowed the claimed depletion. The Circuit Court of Appeals affirmed the Board.

LAW AND ARGUMENT.

Respondent Is Entitled to a Depletion Deduction With Respect to Income Received by Him in 1925 and 1926 Pursuant to the Contract With Petroleum Midway Company, Ltd.

Petitioner employs a more or less ingenious type of dissembling argument reminiscent of that caustically referred to in *Lynch v. Alworth Stephens Co.*, 267 U. S. 364, wherein this Honorable Court aptly stated that:

> "* * * the reasonable allowance for depletion in case of a mine is to be made to everyone whose property right and interest therein have been depleted by the extraction and disposition of the product thereof * * * And the plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover.".

The government in that case ingeniously argued that the depletion allowance applied to the physical exhaustion of the ore deposit, and since the title thereto admittedly was retained by the lessor, his property only was depleted by extraction of ore and he alone was entitled to the depletion allowance. This Court held that regardless of technical ownership of the ore in place the taxpayer by his lease had acquired a very real and substantial interest in the unextracted ore deposits, that such was property and had been depleted.

In *Palmer v. Bender*, 287 U. S. 551, taxpayer assigned certain leases in partial consideration of the sum of $1,000,000.00 payable out of proceeds derived from the sale of one-half the first oil produced and saved. Petitioner

claims the instant case to be unlike *Palmer v. Bender* in that respondent here must necessarily have acquired rather than retained an economic interest; not only suggests that deduction of operating costs and 6% interest on advances made by the operating oil company in determining net profits derived from development and operation of the oil properties affected by the agreement of January 9, 1918 [R. 77-80], renders *Palmer v. Bender* and collateral cases inapplicable, but erroneously insists throughout his brief that taxpayer in *Palmer v. Bender* actually shared in kind in oil produced. Furthermore, petitioner has ingeniously devised innumerable technicalities to obscure and avoid the effect of basic apportionment principles enunciated and reiterated by this Honorable Court, yet studiously avoids quoting the material portion of this Honorable Court's opinion in *Palmer v. Bender,* pp. 556-7, which reads as follows:

> "* * * It will be observed that the statute directs that reasonable allowance for depletion be made as a deduction in computing net taxable income, 'in the case of oil and gas wells, . . . according to the peculiar conditions in each case.' The allowance to the taxpayer is not restricted by the words of the statute to cases of any particular class or to any special form of legal interest in the oil well. It is true that under Article 215 of Treasury Regulations 62 the lessor of an oil or gas well is entitled to a depletion allowance upon the bonus and royalties received from the lessee. See *Murphy Oil Co. v. Burnet,* 287 U. S. 299, *ante,* 318, 53 S. Ct. 161, *supra.* But there is nothing in the statute or regulations which confines depletion allowances to those who are technically lessors. The concluding sentence of the section that 'In the case of leases the deductions al-

lowed by this paragraph shall be equitably apportioned between the lessor and the lessee' presupposes that the deductions may be allowed in other cases. The language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital.

"That the allowance for depletion is not made dependent upon the particular legal form of the taxpayer's interest in the property to be depleted was recognized by this Court in *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 69 L. ed. 660, 45 S. Ct. 274. * * *"

"Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. It is enough, if by virtue of the leasing transaction, he has retained a right to share in the oil produced. If so he has an economic interest in the oil, in place, which is depleted by production. * * *"

This Court, commenting upon the elaborate argument presented by opposing counsel in *Palmer v. Bender*, 287 U. S. 551, with respect to the formal attributes of the instruments there involved, expressly held immaterial artificial technicalities affecting the title to property. Likewise, in the quoted portion of the opinion it will be noted that the allowance for depletion is not made dependent upon respondent having acquired or retained ownership of, or any other particular form of legal interest in, the mineral content of the land. On the contrary, it is re-

quired that the depletion allowance shall be equitably apportioned to every taxpayer who has acquired by investment any interest in the oil in place, and secured by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital. The interest referred to is the so-called economic interest, the existence of which, consequently, is independent of respondent having acquired or retained ownership of, or any other particular form of legal interest in, the mineral content of the land. An economic interest is in fact defined as a right to share in the oil produced, customarily evidenced by the right to receive a share of income derived from the sale of oil produced. Petitioner would require actual receipt of oil in kind. The identical authorities petitioner cites on brief negative his argument, which should no longer require a citation of adverse authority. Receipt of oil in kind is clearly not required, merely receipt of income derived from the extraction of oil, a share in the proceeds of oil produced.

Palmer v. Bender, 287 U. S. 551;

Helvering v. Twin Bell Syndicate, 293 U. S. 312;

Burnet v. Harmel, 287 U. S. 103;

U. S. v. Noble, 237 U. S. 73, 74, 59 L. ed. 844.

In the last cited case this Honorable Court stated:

> "* * * It is said that the leases contemplated the payment of sums of money, equal to the agreed percentage of the market value of the minerals, and thus that the assignment was of these moneys; but the fact that rent is to be paid in money *does not make it any the less a profit issuing out of the land* * * *." (Italics supplied.)

The mere fact that under the contract Midway paid respondent cash instead of oil does not in any wise change the nature of respondent's interest.

Respondent acquired by investment a very real and substantial economic interest, a right to share in the proceeds of oil produced and has in fact secured income derived entirely from the extraction of oil, to which he certainly must look for a return of his capital. An analysis of the following facts will compel the conclusion that respondent acquired something by investment, clearly a property right identical with that formerly possessed by San Gabriel Petroleum Company, which was a depletable property right.

The contract of January 9, 1918 [R. 77-80] provided, and the lower court so found, that Petroleum Midway Company, Ltd., agreed to and did pay respondent one-third of the net profits derived from the development and operation of the oil properties described and enumerated in the oil leases, for and during the unexpired term or terms thereof. Midway merely had the right to operate the property, produce the oil, and before dividing the proceeds derived therefrom, to deduct stipulated interest and expense.

Receipt of income was definitely measured by and contingent entirely upon production of oil, payable only out of oil, if, as, and when produced, and to that extent. Income would cease upon exhaustion of the mineral content or prior expiration of the lease terms, as respondent

was not entitled to income derived by Midway from other oil properties or from any other source whatsoever, but only to the net proceeds of oil if, as, and when produced from these particular properties. Petitioner stipulated [R. 76] to that effect.

Respondent must necessarily look to the oil content for a return of his capital. If petitioner were to strain his ingenuity to the utmost, it could scarcely be contended otherwise, for the oil content of these particular properties is obviously the sole possible source of income to respondent under the contract, and consequently the sole possible source of capital return. It must be admitted that, if not returned through the depletion allowance, respondent's capital will certainly be lost upon total exhaustion of the mineral content or prior expiration of the lease terms. Progressive exhaustion of the mineral content certainly depletes respondent's reservoir of capital to that extent.

Petitioner vigorously contends that receipt of net rather than gross proceeds is fatal to the depletion allowance and that gross income means gross receipts from the oil extracted. Petitioner erroneously insists throughout his brief that gross income is synonymous with gross receipts. The distinction is obvious. Percentage depletion is based on gross income and not gross receipts. The statute refers to the *taxpayer's* gross income. Both respondent and Midway are taxpayers and each has gross income. The amount received by respondent was his gross income and it is that gross income which the statute refers to in determining the amount of the depletion deduction. Neither Midway nor respondent could take a depletion deduction based on a percentage of gross receipts. Midway, in computing its gross income from the property for the pur-

pose of determining its allowance for depletion, was required by Section 204 (c) (2) of the Revenue Act of 1926 to deduct from gross receipts, and thus exclude from gross income, an amount equal to rents and royalties paid or incurred in respect of the property.

Greensboro Gas Co. v. Commissioner, 30 B. T. A. 1362, 79 F. (2d) 701, Certiorari denied 296 U. S. 639;

Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312.

It could scarcely be contended that payments made to respondent were not paid or incurred by Midway in respect of the property. In harmony with that requirement, and for the same basic reason, Congress further provided that the total allowable depletion deduction should be equitably apportioned. Midway as a result ultimately deducted only 66-⅔% of the total allowable depletion. One hundred per cent (100%) of oil produced admittedly depleted the oil content. Someone is entitled to the remainder, obviously, the respondent. The amount he received was his gross income from the property and it is that gross income to which the statute refers.

As a matter of fact, net proceeds merely measured the relative amount respondent received; the deductions merely diminished respondent's economic interest, did not alter its character as such. On the contrary, it would seem indicative of, and entirely consistent with an economic interest that one should bear a pro rata share of operating expense. Respondent might have obtained a one-fourth or greater share of the gross proceeds derived from the sale

of oil and petitioner would probably concede the economic interest and depletion allowance. Yet, although the economic interest remains intact merely because respondent chose to accept one-third and bear his pro rata share of expense, petitioner would deny the existence of the interest.

The position taken by the petitioner in this case is inconsistent with his long continued practice in respect of cases which involve so-called working agreements which are common in the oil industry. These working agreements always have as one party thereto (usually called the first party), a lessee of an oil property and usually have as the second party an operating oil company sufficiently well supplied with capital to develop and operate the lease in question. Under the terms of such an agreement the first party will assign to the second party all of his right, title and interest in and to the lease in consideration of the agreement of the second party to furnish the necessary capital to drill wells and if oil is discovered to operate them and to pay to the first party a fraction of the net receipts derived from the oil produced, saved and sold after the second party has recovered all of his cash outlay in connection with the development and operation of the lease. In such a case, as in the case at bar, the first party's right is the same as respondent's right, namely, the right to share in the net proceeds derived from the production of oil from the property in question. In the cases of the working agreements the petitioner (since this Honorable Court's decision in *Palmer v. Bender*, 287 U. S. 551) has permitted and does now permit the first party, who has only the right to share in net proceeds derived from the sale of oil, a deduction for depletion in an amount equal to 27½% of his interest in the gross income derived from the sale of oil limited to 50% of the net income.

As an illustration: Suppose the situation under a working agreement wherein the assignor, first party of the lease, is entitled to 50% of the net proceeds derived from the production of oil after the assignee recovers his capital; assume that in a given taxable year the gross income, less landowner's royalty, amounts to $100,000.00 and that the net income from the property before allowance for depletion amounts to $50,000.00. The Respondent would allow the first party to the working agreement depletion in the amount of $12,500.00, being in this case one-half of the net income.

Now, the interest which the assignor in a working agreement has in the oil property is merely the right to share in the net proceeds derived from the production of oil; he has no right to demand oil in kind nor does he share in any percentage of the gross proceeds derived from the sale of oil. He simply shares in the net proceeds just the same as respondent does here, but, of course, he does share, like the respondent, in profit flowing from the oil.

This is not a criticism of the petitioner's treatment of depletion in such cases because it seems fair and reasonable that the assignor under a working agreement should be entitled to depletion computed as the petitioner computes it in such cases.

Respondent has not in this case contended that he was entitled to depletion computed upon the basis of one-third of the gross income from the property limited to one-half of one-third of the net income. It would seem, however, that it would be just as logical that he be allowed depletion computed upon that basis as it would be to allow the assignor under a working agreement that depletion. In any event, the Petroleum Midway Company should not be allowed depletion upon that portion of its gross income

payable to the respondent and such an allowance to it violates the requirement that depletion should be apportioned between lessor and lessee.

Petitioner on pages 13 and 14 of his brief for the first time contends that a former case (*Thomas A. O'Donnell v. Commissioner,* 25 B. T. A. 956-963; 64 F. (2d) 634, Certiorari denied 290 U. S. 699) determined that O'Donnell had recouped his entire cost prior to 1923. Petitioner however fails to paint the true picture presented in that case. On the day the case was tried before the Board of Tax Appeals the Commissioner filed a second amended answer wherein he for the first time affirmatively alleged that O'Donnell derived taxable income to the extent of $114,908.31 on account of the receipt by the trustees of revocable trusts of this amount which was derived from the Petroleum Midway Company, Ltd. under and pursuant to the contract of January 9, 1918. Mr. O'Donnell had assigned to the trustees under the revocable trusts the contract of January 9, 1918 [transcript of record pages 25, 40, 54, 95, Supreme Court of the United States, October Term 1933, *Thomas A. O'Donnell v. Commissioner.*] The Board of Tax Appeals held that the income derived by the trustees during 1923 under the revocable trusts, pursuant to the contract of January 9, 1918, constituted taxable income to Mr. O'Donnell, and incidentally held that such income exceeded any possible recoupment of capital to which Mr. O'Donnell might have been entitled. Mr. O'Donnell did not recoup his cost. Nowhere does it appear that the Commissioner allowed a return of capital in previous years, or that Mr. O'Donnell sought such allowance. Incidentally, the Circuit Court of Appeals in that case referred to "the royalty interest he (O'Donnell) retained in the income derived from the oil property."

Mr. O'Donnell in the former case contended that the Board of Tax Appeal's findings of fact and opinion were based on issues not raised by the pleadings and contended that if the income was taxable to Mr. O'Donnell (since it was derived as a royalty from oil property) the case should be remanded for further proceedings to determine the depletion allowance on the proceeds derived from mineral properties. (Brief in support of petition for writ of certiorari to this Court, *O'Donnell v. Commissioner*, p. 17.) Mr. O'Donnell felt that a grievous injustice had been done him in the denial of his petition to have the case remanded to determine the depletion on this income from oil properties. This Honorable Court's denial of O'Donnell's petition for certiorari was entered prior to the decision of this Honorable Court in *Guy T. Helvering, Commissioner of Internal Revenue v. Gowran*, decided December 6, 1937, wherein this Court remanded that case to the Board to determine a new issue.

A reference to the former case of O'Donnell and particularly the Board's findings of fact (*Thomas A. O'Donnell v. Commissioner*, 25 B. T. A. 956-963) shows that in March, 1917, Mr. O'Donnell, M. L. and L. A. McCray for a nominal consideration, secured five development oil leases and that in June, 1917, they transferred these leases to a corporation organized by themselves—the San Gabriel Petroleum Company—for all of its capital stock, each receiving one-third thereof and that thereafter Mr. O'Donnell acquired all the stock owned by the two McCrays. This record also shows that these same leases in which Mr.

O'Donnell had an interest prior to the organization of the San Gabriel Petroleum Company were transferred to the Petroleum Midway Company, Ltd. under and pursuant to the contract of January 9, 1918. It, therefore, follows that Mr. O'Donnell originally acquired an interest in the leases and does now have an interest therein, at least to the extent of sharing in the proceeds derived from production. When the record in that case is considered (as counsel for the petitioner assumes it should be) it is seen that Mr. O'Donnell had and does now have a very direct interest in the leases and the oil properties covered thereby. Mr. O'Donnell's interest in the leases and the oil properties covered thereby eloquently explains the reasons why the following provision was incorporated in the contract of January 9, 1918 [R. 79]:

> "Second party further agrees to comply with all the terms and conditions of the various leases, contracts and agreements now owned by said San Gabriel Petroleum Company, and to do and perform each and all such acts and things as may be necessary to protect said leases, contracts and agreements from cancellation or forfeiture."

Of course, Mr. O'Donnell, having an interest in the leases themselves with the consequent obligations of performance, was naturally desirous of protecting himself against the cancellation or forfeiture of these leases, and was also anxious that he not run any risk on account of the failure of the Petroleum Midway Company to fully comply with the provisions of the leases. The facts, therefore, demonstrate that Mr. O'Donnell at all times has had

and does now have a direct interest in the leases and in the oil properties which interest certainly entitles him to depletion under the specific provisions of the Revenue Act. The defense that O'Donnell made in the prior case certainly is not sufficient to deny him the right which the law specifically gives.

The case of *Commissioner v. Elliott Petroleum Corp.*, 82 F. (2d) 193, is sufficient authority that the defense made by Mr. O'Donnell in the prior case would not be binding or have any effect in the case at bar.

Conclusion.

The decision of the Board of Tax Appeals and of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX.

Revenue Act of 1926, c. 27, 44 Stat. 916:

SEC. 204. * * *.

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * * * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½% per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

SEC. 214 (a) In computing net income there shall be allowed as deductions:

* * * * * * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * * * * * *

Revenue Act of 1928, c. 852, 45 Stat. 799:

SEC. 23. * * *

(1) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. (For percentage depletion in case of oil and gas wells, see section 114 (b) (3).)

* * * * * * * * *

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

October Term, 1937.

No. 406.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

vs.

THOMAS A. O'DONNELL,

Respondent.

PETITION FOR REHEARING AND MOTION TO STAY ISSUANCE OF MANDATE.

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GUY T. HELVERING, Commissioner of Internal Revenue,

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THOMAS A. O'DONNELL,

Respondent.

PETITION FOR REHEARING.

Comes now Thomas A. O'Donnell by his attorneys, Thomas R. Dempsey and A. Calder Mackay, and presents this his petition for a rehearing of the above entitled cause (judgment having been entered on March 7, 1938) under Rule 33 of the Revised Rules of the Supreme Court of the United States, and in support thereof respectfully urges:

THAT THE DECISION OF THIS HONORABLE COURT IS CONTRARY TO THE DECISIONS OF THE SUPREME COURT OF THE STATE OF CALIFORNIA DETERMINING PROPERTY RIGHTS AND THAT, THEREFORE, THE DECISION OF THIS HONORABLE COURT IS CONTRARY TO THE DECISIONS RENDERED BY THIS COURT IN THE CASES OF FREULER V. HELVERING, 291 U. S. 35, 54 Sup. Ct. 308, 13 A. F. T. R. 834, AND SHARP, EXECUTORS, V. COMMISSIONER OF INTERNAL REVENUE, SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM 1937, DECIDED MARCH 14, 1938, 384 C. C. H. PAR. 9184; THAT THE DECISION OF THIS HONORABLE COURT IS IN ERROR IN HOLDING THAT THE AGREEMENT ENTITLING MR. O'DONNELL TO SHARE IN THE PROCEEDS OF PRODUCTION WAS MERELY A PERSONAL COVENANT ON THE PART OF THE PETROLEUM MIDWAY COMPANY, LTD.

It is the established principle of property law in the State of California that a right of one to share in the proceeds of production of oil survives the conveyance of the fee in the general estate in the land and gives to the one entitled to share in the proceeds the right to receive his percentage of the proceeds from whoever produces oil on the premises. In short, it is the established rule of property law in the State of California that one entitled to share in the proceeds of production from oil properties is enforcible in equity against the *res*. It has been recognized by this Court in the case of *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 69 L. Ed. 660, and other similar cases, that property rights and interests in minerals and the incomes derived therefrom by lessees and others, than those who own the titles, are much more valuable than the rights and interests of such owners, and it is difficult to believe that Congress intended by this grant of reasonable allowances for depletion to restrict the allowance as this Court has done in the instant case.

In the case of *Schiffman v. Richfield Oil Co. of California*, 64 Pac. (2d) 1081, decided February 25, 1937, the Supreme Court of the State of California held that the purchaser of a participating oil agreement had more than merely a personal covenant on the part of the operators of the properties to pay a sum of money measured by the net proceeds of production. It appeared that the lessees

of the oil properties had transferred to a trust the lease on specific oil properties and, in order to raise the money to drill, had sold participating agreements which gave to the trust the sole power of operating the properties but gave to the holders of the participating agreements the right to share in the net proceeds of production. The trustees after operating the properties for some time made an assignment and transfer of the leases and its rights to operate them to the Richfield Oil Company. The latter company refused to recognize the right of the holders of the participating agreements to share in the oil produced, contending that the participating agreements were merely a personal covenant on the part of the trust to pay the participants a sum of money which did not give them an interest in the *res*. In this case the Supreme Court of the State of California said at page 1086:

> "* * * The assignments in the instant case, appellant contends, are personal covenants of the Monrovia Oil Company for payment of sums of money, and are not binding upon defendant as assignee of the sublease. * * *"

At page 1087:

> "* * * These royalty assignments were not limited to oil to be produced under the existing lease, but were without limitation as to time. * * * Upon the termination of the lease, the royalty assignees would become tenants in common with each other, and with the lessor if he had retained an interest, in the profit *a prendre* to develop and produce oil. The right of profit survives the conveyance of the fee in the general estate in the land, and *gives the royalty assignee the right to receive his percentage of the proceeds from whoever produces oil on the premises.*" (Italics supplied.)

"If the effect of the percentage assignments was to create an undivided interest in the assignees in the leasehold estate, that is, in the right of profit to drill for and produce oil, notwithstanding it was understood that the lessees should retain exclusive management of the production enterprise, then as to such assignees the lessees are operating the well as their agents, or in some representative capacity. * * *"

At page 1088:

"We are of the view that whether or not the royalty assignments in this case transferred to the holders thereof an interest in the leasehold, that is, in the profit *a prendre* to produce oil, in any event they vested in the holders a right to share in the proceeds of oil produced during the continuance of the lease by an assignee of the lease with notice. * * *"

"The rights of the holders of royalty assignments to an interest in the proceeds of oil produced by an assignee of the leasehold should not depend on whether the assignment is of a percentage of the oil 'to be produced, saved, and sold,' as in Western Oil, etc., Co. v. Venago Oil Corp., *supra*, or is of a percentage of the net proceeds as in the instant case. * * *"

At page 1089:

"* * * *It is certainly not within the contemplation of the royalty holder that in addition to the other risks involved, the lessee may at any time terminate the royalty holder's interest by assigning the lease, and leave the royalty holder either remediless or with a claim for a share of the price received by the lessee for the transfer of the leasehold, or a claim for monetary damages.*" (Italics supplied.)

"* * * In contracts relating to land, the equitable conversion of title to the buyer and the remedy of specific performance may be asserted against a purchaser of the land with notice. Where royalty assignments are made by a lessee, the holders thereof have an interest in oil produced by an assignee of the leasehold covering the land from which the oil is to be produced who acquires the leasehold with notice, or in the proceeds thereof. * * *"

The foregoing decision of the Supreme Court of the State of California establishes a property right and therefore it is respectfully submitted that this Court is bound by the views of that court. (*Freuler v. Helvering,* 291 U. S. 35, 54 Sup. Ct. 308, 13 A. F. T. R. 834, and *Sharp, Executors, v. Commissioner of Internal Revenue,* Supreme Court of the United States, October Term 1937, decided March 14, 1938, 384 C. C. H. Par. 9184).

If Mr. O'Donnell merely acquired under the terms of the contract with Petroleum Midway Company, Ltd. a personal covenant on the part of the Petroleum Midway Company, Ltd., the bankruptcy of that company would defeat the rights of Mr. O'Donnell. This is just exactly what the Supreme Court of the State of California has prohibited.

This Honorable Court in its opinion states:

"* * * The ownership of the oil and gas properties was in the corporation. When the Midway Company acquired these properties from the San Gabriel Company and operated them, the Midway Company became the owner of the oil and gas produced. * * *"

These statements are in direct conflict with the established property laws of the State of California. This Court further stated:

> "* * * No trust was declared by which respondent could claim an equitable interest in the *res.* * * *"

This statement likewise is directly in conflict with the decisions of the Supreme Court of the State of California and is therefore contrary to the principles of law established by this Court in such cases as *Freuler v. Helvering,* 291 U. S. 35, 54 Sup. Ct. 308, 13 A. F. T. R. 834, and *Sharp, Executors, v. Commissioner of Internal Revenue,* Supreme Court of the United States, October Term 1937, decided March 14, 1938, 384 C. C. H. Par. 9184.

Under the contract the Midway Company not only agreed to share the proceeds of production with Mr. O'Donnell but it agreed

> "to comply with all the terms and conditions of the various leases, contracts and agreements now owned by said San Gabriel Petroleum Company, and to do and perform each and all such acts and things as may be necessary to protect said leases, contracts and agreements from cancellation or forfeiture." [R. 79.]

This provision indicates that Mr. O'Donnell was protecting his interest in the *res* not merely to get an economic advantage but to protect his interest in the leaseholds themselves. In this contention it should not be forgotten that Mr. O'Donnell with others, was the original lessee who had transferred the leases to the San Gabriel Petroleum Company. This fact makes the case even stronger than the case of *Schiffman v. Richfield Oil Co. of California,* 64 Pac. (2d) 1081, because it shows definitely that

if the Petroleum Midway Company should permit a forfeiture of the lease that Mr. O'Donnell would thereby become responsible to the lessors and would have a right to do the operating himself.

While it is true that if there were no net profits Mr. O'Donnell would not receive anything, but under these circumstances neither would the Petroleum Midway Company. In short, the economic interests of both depended upon the economic production—the realization of net profits. Unless there were net profits, naturally no one would be entitled to depletion because the statute limits depletion to 50 per cent of the net and 50 per cent of nothing, of course, equals nothing. Petroleum Midway Company, Ltd. certainly did not own the 100 per cent economic interest of the oil properties. When it paid Mr. O'Donnell his share of the proceeds it was merely buying an economic interest in the proceeds of production. Petroleum Midway Company, Ltd. under no stretch of the imagination is entitled to depletion on the amount paid to Mr. O'Donnell. Its gross income naturally would be the amount received less amounts paid to a land owner and to Mr. O'Donnell. Mr. O'Donnell's investment in the proceeds of production was as much of a capital investment as was the investment of the Midway Company. Capital does not merely consist of money, it may consist of stock. That is what Mr. O'Donnell transferred for his interest in the oil properties. This stock was no less capital than cash would have been.

The decision of this Honorable Court in the instant case is of very great importance to taxpayers throughout the land. It is unlike other cases with which it was wrongfully grouped. Merely because a processor of gas does not have an interest in the *res* is no reason for holding

that under the circumstances in this case Mr. O'Donnell likewise does not. The opinion of this Court, as heretofore indicated, is in direct conflict with the property laws established by the Supreme Court of the State of California. It is also, we respectfully submit, contrary to the many decisions of this Honorable Court in such cases as the cases of *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 69 L. Ed. 660; *Palmer v. Bender*, 287 U. S. 551, 77 L. Ed. 489, and similar cases and the other cases herein cited.

We sincerely urge that the decision of this Honorable Court works a grave injustice upon this taxpayer and will unjustly affect many taxpayers similarly situated. It is of vital importance and therefore we sincerely urge that this petition be granted and that Mr. O'Donnell be given an opportunity of orally presenting this matter before this Honorable Court.

Respectfully submitted,

THOMAS R. DEMPSEY,
A. CALDER MACKAY,
1104 Pacific Mutual Building,
Los Angeles, California,
Attorneys for Thomas A. O'Donnell.

Certificate of Counsel.

I, A. Calder Mackay, counsel for Thomas A. O'Donnell, do hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay.

A. CALDER MACKAY,
Counsel for Thomas A. O'Donnell.

IN THE

SUPREME COURT

OF THE

UNITED STATES.

October Term, 1937.

No. 406.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

vs.

THOMAS A. O'DONNELL,

Respondent.

Motion to Stay Issuance of Mandate.

Now comes Thomas A. O'Donnell, by his attorneys, Thomas R. Dempsey and A. Calder Mackay, and shows to this Court:

Within the time allowed by the rules of this Court said Thomas A. O'Donnell is filing his petition for a rehearing of this cause and a modification of the judgment of this Court entered herein on March 7, 1938, for the reasons set forth in said petition.

Under Rule 31 of this Court such petition will not operate to stay the mandate of this Court, and such mandate will issue as of course after the expiration of twenty-five (25) days from the day said judgment was entered, unless otherwise ordered.

In view of the nature of said petition for rehearing and the end sought to be accomplished thereby, no useful pur-

pose would be subserved by the issuance of the mandate of this Court prior to the disposition of said petition; but, on the contrary, unnecessary complications would result.

Wherefore, said Thomas A. O'Donnell prays that the mandate of this Court be stayed and withheld until said petition for a rehearing shall have been acted upon and disposed of by this Court.

THOMAS R. DEMPSEY,
A. CALDER MACKAY,
1104 Pacific Mutual Building,
Los Angeles, California,
Attorneys for Thomas A. O'Donnell.

SUPREME COURT OF THE UNITED STATES.

No. 406.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Thomas A. O'Donnell.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[March 7, 1938.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

Respondent, Thomas A. O'Donnell, owned one-third of the capital stock of the San Gabriel Petroleum Company. By contract of January 9, 1918, he sold this stock to the Petroleum Midway Company, Ltd. As consideration, the Midway Company agreed to pay to respondent one-third of the net profits from the development and operation of the oil and gas properties then owned by the San Gabriel Company and which the Midway Company agreed to acquire. That acquisition was made, the properties thus acquired were developed and operated, and one-third of the net profits thus derived were paid to respondent to August 4, 1926. With respect to such payments in the years 1925 and 1926, respondent claimed deduction for depletion, which the Board of Tax Appeals allowed, overruling the Commissioner of Internal Revenue. 32 B. T. A. 1277. The Circuit Court of Appeals affirmed the decision of the Board. 90 F. (2d) 907. We granted certiorari. — U. S. —. See *Helvering* v. *Bankline Oil Company,* decided this day.

The question is whether respondent had an interest, that is, a capital investment, in the oil and gas in place. Revenue Act of 1926, sec. 204 (c) (2); sec. 214 (a) (9). *Palmer* v. *Bender,* 287 U. S. 551, 557; *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312, 321; *Thomas* v. *Perkins,* 301 U. S. 655, 661; *Helvering* v. *Bankline Oil Company, supra.* As a mere owner of shares in the San Gabriel Company, respondent had no such interest. Treasury Regulations No. 69, Art. 201. The ownership of the oil and gas properties was in the corporation. When the Midway Company acquired these properties from the San Gabriel Company and operated them, the

Midway Company became the owner of the oil and gas produced. It was the owner of the gross proceeds or income upon which the statutory allowance for depletion was to be computed. *Helvering* v. *Twin Bell Syndicate, supra.* The agreement to pay respondent one-third of the net profits derived from the development and operation of the properties was a personal covenant and did not purport to grant respondent an interest in the properties themselves. If there were no net profits, nothing would be payable to him. No trust was declared by which respondent could claim an equitable interest in the *res.* As consideration for the sale of his stock in the San Gabriel Company respondent bargained for and obtained an economic advantage from the Midway Company's operations but that advantage or profit did not constitute a depletable interest in the oil and gas in place. *Palmer* v. *Bender, supra; Helvering* v. *Bankline Oil Company, supra.*

The judgment of the Circuit Court of Appeals is reversed and the cause is remanded for further proceedings in conformity with this opinion.

It is so ordered.

Mr. Justice CARDOZO and Mr. Justice REED took no part in the consideration and decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.